COSTS AND AVAILABILITY OF LIABILITY INSURANCE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

MARCH 13, 17, 24; AND APRIL 28, 1986

PART 1

MARCH 13 AND 17, 1986

Serial 99-76

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
61-766 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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COSTS AND AVAILABILITY OF LIABILITY INSURANCE

THURSDAY, MARCH 13, 1986

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[Press releases announcing the hearings follow:]

FOR IMMEDIATE RELEASE
WEDNESDAY, FEBRUARY 26, 1986

PRESS RELEASE #16
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS TO EXAMINE THE COSTS AND AVAILABILITY OF LIABILITY INSURANCE

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, announced today that the Subcommittee will hold hearings to examine issues surrounding the costs and availability of liability insurance. The hearings are scheduled for Thursday, March 13, and Monday, March 17, 1986, and will be held in room 1100 Longworth House Office Building beginning at 9:30 a.m. both days.

Specifically, the Subcommittee will focus on the reasons why the cost of liability insurance has increased dramatically in recent years, the extent to which liability insurance has become unavailable to certain segments of the economy, and how high costs and decreased availability affect programs within the jurisdiction of the Committee on Ways and Means. In reviewing the overall problem, the Subcommittee will consider the impact on medical services provided under the medicare program, and day care centers that are funded through Title XX of the Social Services Block Grant. The Subcommittee will discuss trade issues including the extent to which liability insurance costs have forced U.S. firms to move operations and jobs overseas, the competitive advantage gained by firms obtaining insurance overseas or self-insuring offshore, and the liability exposure of U.S.-insured firms for activities taking place outside the U.S. The Subcommittee also will consider the current use of self-insurance by U.S. firms and alternatives thereto.

The Subcommittee will receive testimony from invited witnesses including government representatives, academic and economic experts, parties adversely affected by high insurance rates or the unavailability of insurance, and representatives from the insurance industry for the limited purpose of discussing the causes and scope of the current situation. The Subcommittee emphasizes that testimony will not be received to discuss specific tax provisions or the impact of H.R. 3838, the Tax Reform Act of 1985, as applied to property and casualty insurance companies. Such issues were recently the subject of extensive full Committee hearings and discussions with industry officials.

In announcing the hearings, Chairman Pickle stated, "The Members of the Subcommittee on Oversight are very interested in determining the reasons why liability insurance rates have skyrocketed in recent years to the point where liability insurance either has become prohibitively expensive, or totally unavailable. We receive reports daily from individuals, businesses, and local authorities in our districts indicating that they have had to shut down their business or curtail operations because of the current insurance situation. As the Subcommittee with oversight jurisdiction over numerous health, social services, and trade programs, we have an obligation to determine why this is happening. The availability of liability insurance goes to the heart of what this Committee can expect in the coming years in terms of a growing and well diversified economy."

* * * * * *

FOR IMMEDIATE RELEASE
FRIDAY, APRIL 18, 1986

PRESS RELEASE #19
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES ADDITIONAL HEARING ON THE COST AND AVAILABILITY OF LIABILITY INSURANCE

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today an additional day of hearings (see also Press Release #16, dated February 26, 1986) to examine issues surrounding the cost and availability of liability insurance. The hearing will be held on Monday, April 28, 1986, beginning at 9:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.

Specifically, the Subcommittee will consider the pricing policies of the property and casualty insurance industry, the appropriateness of recent premium rate increases, and the future financial condition of the insurance industry. Witnesses invited to appear at the hearing will be representatives from the Insurance Services Office, Incorporated (ISO) and the U. S. General Accounting Office (GAO).

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons desiring to present a written statement for the printed record of the hearing should submit at least six (6) copies, by the close of business, Monday, May 19, 1986, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D. C. 20515.

If those filing written statements for the printed record of the hearing wish to have their statements distributed to the press and the interested public, they may provide 150 additional copies for this purpose to the Subcommittee office, 1105 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS FOR HEARING STATEMENTS AND EXHIBITS:

Each statement presented by a witness or any written statement or exhibit submitted for the printed record of the hearing must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be included in the printed hearing record, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for the printed hearing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear, as well as any clients or persons, or any organization for whom the witness appears.

(MORE)

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or a designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record of the hearing.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted only for distribution to the Members, the press and public, may be submitted in other forms.

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* * * ADDITIONAL DAY OF HEARINGS * * *

FOR IMMEDIATE RELEASE
WEDNESDAY, MARCH 19, 1986

PRESS RELEASE #16-REVISED
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES ADDITIONAL HEARING ON THE COST AND AVAILABILITY OF LIABILITY INSURANCE

The Honorable J. J. Pickle (D., Texas), Chairman, of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today an additional day of hearings to examine issues surrounding the costs and availability of liability insurance. The hearing will be held on Monday, March 24, 1986, beginning at 9:00 a.m., in the Main Committee Hearing Room, 1100 Longworth House Office Building.

All other details for the hearings remain the same (see Press Release #16, dated February 16, 1986).

* * * * *

Chairman PICKLE. The subcommittee will come to order. We ask our guests to please take a seat so that we may proceed.

I am going to make a preliminary statement and then yield to other members for any statement they want to make.

Today the Oversight Subcommittee begins hearings on an issue that has the potential to cripple large parts of American society, the disappearance and high cost of liability insurance. When we first heard about this problem a few years ago it was generally limited to medical malpractice. Since then it has spread to many other areas.

The cost of vaccines against childhood diseases has skyrocketed because of increases in insurance premiums. Major corporations are having difficulty convincing people to serve on their boards because of an absence of liability insurance. And the parks in Denver have outlawed sledding because of the absence of appropriate coverage. Some say we are getting to the point where it appears that the slogan of the United States is "Sue the rascals." I have heard that the new American dream is a search for the proverbial "deep pocket."

We are particularly interested in the impact of the insurance crisis on areas where the Ways and Means Committee has jurisdiction. When cities cannot provide services to welfare recipients because they lack insurance, we are concerned. When day care centers and other charitable organizations are unable to implement the programs this committee funds because they lack insurance, we have to face some hard questions and find some answers. And when American companies are forced to seek insurance coverage overseas, we are also concerned.

We are especially concerned when there is a need for insurance but it is not available at any cost.

We want to know the causes of the problem, its current dimensions and what should be done. There is a significant disagreement on each of these points.

The current situation is intolerable and it is getting worse. This is a problem that was not created by the Government and probably should not be solved by it. But we do have a responsibility to define the problem and press those who have the power to resolve it. We should also be looking to create a climate that will encourage solutions.

Now I am going to make this specific point to you. This hearing today is not being held to question the provisions of the committee's tax reform bill as it applies to property and casualty insurance companies. We are not prepared to discuss or make recommendations on taxes. Further, the subcommittee's hearings have not been designed to produce or deal with specific liability insurance legislation. There is no specific bill pending.

Rather, the subcommittee has an enormous task before it. We have developed a broad-based, comprehensive schedule of witnesses to cover all perspectives and concerns. All the facts and arguments, pro and con, need to be compiled and assimilated by this subcommittee. After this is done, we will be in a position to report to the full committee and to the administration in a helpful manner.

Now we have got a long day ahead of us. I am going to repeat again, to each one of the witnesses, that we are going to ask you to limit your testimony to 5 minutes. And similarly, the members will try to limit their questioning to a 5-minute period. Then we will be able to go back again, if there are additional questions to be asked.

We have several panels today and we primarily want to get testimony on the record. So we will try to proceed as expeditiously as we can.

Now the Chair would yield to Mr. Schulze for any opening statements.

Mr. SCHULZE. Thank you, Mr. Chairman.

These hearings, which you have scheduled on liability insurance, are probably the most timely and important hearings our subcommittee will conduct this year. The crisis with respect to the cost and availability of liability insurance is having pervasively dire effects throughout our society.

Reports of State and local governments not being able to provide police or fire protection, or to transport children to school are bad enough. On top of this, however, we have doctors not performing surgery or delivering babies; day care centers closing and hazardous waste companies refusing to process additional waste. Perhaps the greatest threat to our economic well-being is the effect on our small business and manufacturing industries. Businesses are closing down or going without insurance. Jobs are being lost and eventually, without a change in the current situation, insurance costs will make our industries less competitive with our trading partners. My constituents, and yours, are demanding solutions to the sky-rocketing costs of insurance and to the availability crisis as well.

Before we take action at the Federal level, if indeed action is a solution, we must understand the many factors involved. This will not be easy. Addressing the problems will be complicated by the dissimilarity of the industries affected. A cross section of solutions involve Federal and State tort law, State insurance regulation, and social and economic groups from a wide range of American business, consumers, professional and governmental units.

Hopefully, these hearings which have been scheduled will allow us to at least examine all major factors involved in causing the current crisis. We will know more about the effect of the crisis on the economy and our society in general, and we may find actual solutions to the problems. We may also find that everyone involved is to blame for the situation we find ourselves in. If this is the case, this is one forum where perhaps we can obtain a consensus for action.

I am particularly pleased with the diverse group of witnesses which will be appearing before the subcommittee and look forward to hearing their testimony.

Mr. Chairman, I might add that I have been working on developing legislation to address this insurance availability crisis and I intend to refine that as we go through these hearings and perhaps work on introducing it in the next week or so.

Chairman PICKLE. Thank you, Mr. Schulze.

Now, does any other member want to have an opening statement? Mr. Dorgan?

Mr. DORGAN. Thank you, Mr. Chairman.

I just briefly wanted to thank you for holding these hearings and I would like to include a statement at the start of these hearings into the record.

I would like to say that we have a society these days in which people think that the proverbial pot at the end of the rainbow seems to end on the courthouse steps. That has created a lot of problems and, as is so often the case, the existence of a problem is far easier to recognize than the cause.

I think we do have a society that is overly anxious to litigate and in which some view our legal tort system as a lottery to which they are owed a ticket. We have an insurance industry that seems now forced to admit that it ignored logical economic common sense by underpricing policies so that it could obtain more capital to build its investment portfolios.

We have a plaintiff's bar that applauds itself as the defender of every man and allies itself with civil libertarians while downplaying the fact that it receives, in some cases, 40 percent and more of the settlements and judgments along the way. We have a press that trumpets the headlines of outrageous verdicts but reduces to back pages the news that the trial and appellate judges have reduced or dismissed some of those very same verdicts.

So each points an accusatory finger at the other. We do have a problem. We have got to solve it.

These hearings represent, I think, the first step for us to begin to understand it. Once we understand it, at that point, I think we can begin developing some approaches to find a solution for everyone in this country.

Again, Mr. Chairman, thank you for taking the leadership to call these hearings.

[Mr. Dorgan submitted the following:]

OPENING STATEMENT OF HON. BYRON L. DORGAN

Thank you, Mr. Chairman, for calling this hearing to address a very serious problem in our country today. I appreciate the time to say a few words about my ideas on the subject.

There is a serious property/casualty insurance crisis in this country. Our society has become one that seeks and expects as a personal right to be made whole or even wealthy when injured physically, emotionally or in any way. In recent years, the search for the "pot of gold at the end of the rainbow" seems to have centered on the steps of our courthouses.

Something is dramatically wrong. That becomes more apparent to each of us as we read daily of absurd lawsuits and verdicts such as that when a customer's dog attacks another patron, the owner of the business can be held liable. Or, when an infant chokes on peanut butter, the parents sue the maker for not printing on the lable that peanut butter can be dangerous to small children.

It is tragic and frightening, when the results of such lawsuits impact on our economy and on our very safety and quality of life. We read each day of businesses that are forced to shut down, of health care professionals no longer able to offer the services for which they have been trained, of local governments terminating recreational and service programs. All because of insurance premiums that have escalated to unaffordable levels, if available at all.

As is often the case, the existence of a problem is far easier to recognize than the cause. We have a society that is overly anxious to litigate in which some view our legal tort system as a lottery to which they are owed a ticket. We have an insurance industry that has been forced to admit that it ignored logic or economic common sense by underpricing policies so that it could obtain more capital to build its investment portfolios. We have a plaintiffs bar that applauds itself as the defender of every man and aligns itself with the civil libertarians while downplaying that it is receiving 40% and more of these settlements and judgments along the way. We have a press that trumpets in its headlines the outrageous verdicts, but reduces to the back page the news that the trial and appellate judges have reduced or dismissed these very same verdicts. Yet each points an accusatory finger at the other.

I suspect that what we are going to learn through these hearings is that each is right and each is to blame. But I don't think we are here to determine blame, but rather, to find the cure.

While American tort law and regulation of the insurance industry has long been within the purview of the States, I think that as a responsible Congress we need to consider what we can do to help ease the problem. Perhaps uniform Federal product liability laws are in order. Perhaps a model malpractice and negligence code is appropriate. Certainly limits on attorneys' contingency fees, a cap on the amount of noncompensatory damages and court imposed penalties for the filing of frivolous law suits are reasonable remedies to be considered.

We need to keep in mind throughout these hearings, and as we seek solutions, that this very same system that has brought well deserved compensation to many who have been injured, that has forced our producers to design and manufacture safer products and that has made our health care profession seek higher standards. But the system is in trouble and it needs some repairs.

This is a complex problem. I hope that through the testimony we receive during these hearings that we are able to make significant progress toward the solution.

[Subsequent to the hearing, the following letter was received:]

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, DC, March 21, 1986.

Rep. J.J. PICKLE,
Chairman, Subcommittee on Oversight, Ways and Means Committee, Washington, DC.

DEAR JAKE: Thank you for calling hearings of the Subcommittee on Oversight on the very serious problem of skyrocketing insurance rates and, in far too many cases, the unavailability of insurance at all. I have found the testimony of the members of the panels to be insightful and useful as we examine this issue. Not surprisingly, the opinions as to the causes and the cures of the "insurance crisis" were extremely diverse.

This is an extremely complex problem and it is one without an easy answer.

It has become quite clear to me that the insurance industry is at least in part responsible for the serious financial difficulties it is experiencing. In the early 1980's the industry defied logic or economic common sense by underpricing policies so that it could obtain more capital for their investment portfolios. It is now feeling the consequences of this financial mismanagement.

It is equally clear that both the number and economic value of lawsuits, settlements and verdicts have increased at an unprecedented pace. We have become a society that is overly anxious to litigate and expects our legal system to remedy all of life's misfortunes.

American tort law and regulation of the insurance industry have long been primarily within the purview of the States. In my view, we at the Federal level should not be quick to try to usurp that authority. But, at the same time, we cannot ignore this problem that is affecting us all. We need to study and develop means to rectify a situation that is rapidly becoming out of control. By proposing model legislation and recommending solutions, we can be of vital assistance to the States as they attempt to deal with the so-called "insurance crisis."

There are a myriad of potential remedies that are being proposed and which we must consider. The long standing exemption from Federal antitrust laws that the insurance industry has enjoyed should be reexamined. Perhaps less restrictions should be imposed preventing businesses and professions from joining together to purchase insurance or to self insure. Among the many proposed changes in our tort law system that need to be considered are limits on non-compensatory damages, court imposed penalties for the filing of frivolous lawsuits, limits on attorneys' contingency fees and elimination of the principle of joint and several liability.

I also believe that development of a system by which a panel would have first and exclusive jurisdiction to conduct preliminary hearings on lawsuits but would not preclude appellate review is an idea that has merit. Chief Justice Burger has long been advocating such a system as a means of remedying the serious court congestion and delay problems.

I have outlined only a few of the many proposals now before the Committee. I am certain that there is no one easy solution, but, rather it lies in a subtle combination of the many good ideas that have been presented.

Thank you foı calling such timely hearings. I look forward to working with you and our other colleagues on the Committee in taking appropriate action.

Sincerely,

BYRON L. DORGAN,
Member of Congress.

Chairman PICKLE. Thank you, Mr. Dorgan.

Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman.

I would like to commend you also for holding these hearings on the liability insurance crisis. It is an issue that is having a great impact on the municipalities and small businesses across the Nation.

There are several risks which are presently uninsurable, at any price, in New York State. These include contractors who handle hazardous substances and asbestos removal contracts. In addition, there is no ordinary liability insurance available for 117 schoolbus companies under contract with the New York City Board of Education. And there is no coverage for participants in school athletic events.

In my own congressional district on Long Island, I have heard from schoolbus operators, towns and villages, doctors, and many others about the lack of availability and the high cost of liability insurance. And in fact, at a small business forum recently in my district, the availability and cost of liability insurance was listed as the No. 1 concern facing small businesses.

One statistic which I think is indicative of the crisis is that, according to the Insurance Information Institute, commercial liability insurance premiums rose 72 percent from 1984 to 1985. I am afraid that this is the type of situation that is not going to go away before it comes to a head.

As we move into the summer season, municipalities are confronted with the possibility that pools and beaches will not be able to open because they have no insurance. Sewanhaka School District, in my congressional district, has buses that are not operating. All of a sudden, when the pools do not open and the beaches do not open, and there is no recreation programs in the summer for the kids out of school, the public is going to demand quick action.

The causes to this crisis seem to be diverse, as expected. The lawyers are blaming the insurance companies, the insurance companies are blaming the lawyers and the court system. And as Mr. Dorgan pointed out, many of the practices of the insurance companies over the past 6 years have been suspect.

However, the time for action is now. I certainly do not know what the answer to this situation is. However, I think we should step cautiously in this area since there has not been a large role for the Federal Government as a result of the passage of McCarran-Ferguson.

There are several bills presently before the House and the Senate and I think we have to review them before a decision can be decided on.

I am not at all sure that the answer lies in action at the Federal level. There has been a great deal of activity in this area at the

State level, which I interpret as a willingness to deal with the problem at that level. More than 300 bills were introduced last year in State legislators calling for the reform of the civil justice system and changes in insurance regulation. Of the 50 that were enacted, 20 were tort reform bills. To date, more than 40 States have shortened the time period after an injury in which a person can sue for medical malpractice.

Some States, including California, have established caps on awards for pain and suffering, limited attorney's contingency fees, or done both.

It is my opinion that only if the States cannot or will not take action, then perhaps there is a role for the Federal Government. And once again, Mr. Chairman, I want to congratulate you for these hearings that will look closely into the causes of this problem.

Chairman PICKLE. Thank you, Mr. McGrath.

Mr. Ford?

Mr. FORD. Thank you, Mr. Chairman.

Mr. Chairman, let me join with my colleagues on the committee in thanking you and commending you for such a timely Subcommittee on Oversight meeting on the subject of property and casualty liability coverage.

Mr. Chairman, I have heard from many businesses and concerns about a major insurance crisis that is moving like a brush fire across this Nation. The crisis is destroying American businesses with unaffordable premiums and complete unavailability of coverage in many cases. Commercial insurance prices in Memphis and across the Nation have skyrocketed 100, 200, 300 percent, and in some cases, even more.

I know of one hospital in Memphis that has suffered a 1500-percent increase in its officers and directors coverage. Day care centers, hospitals, restaurants, commercial trucking, nurse midwives, State and local government and numerous other concerns are impacted by this insurance crisis

The escalating prices of property and casualty insurance have caused many, many problems. Insurance is a prerequisite in most businesses and service activities in America. One successful liability claim can devastate a company's assets and put it out of business within a short period of time.

Today's crisis raises substantial questions about the way the Nation's insurance industry provides property and casualty liability coverage to businesses and other consumers. Many property and casualty insurers place the blame for insurance price increases on the tort system, and meaningful tort reform will be needed probably in the coming years. However, the reasons for the current availability and affordability problems are much more complicated.

Regulation of the insurance industry has resided with the States since passage of the McCarran-Ferguson Act in 1945. This authority should remain with the States.

But today's crisis demands that the creation of ongoing Federal oversight. Congress visited the issue of dangerously high insurance premiums in the late 1970s and promptly forgot it shortly there afterwards.

Today's insurance crises and our congressional responsibility to the business and consumers of this Nation will not be forgotten this go round.

Mr. Chairman, once again, I commend you and hopefully we can move in the right direction to bring some solutions to the problems with which we are faced.

Chairman PICKLE. Thank you, Mr. Ford.

Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

I have a letter here from one of my constituents who says that he writes me a lot when he is not pleased with my positions, but now he says, "I feel I need to now shift positions and compliment you on you leadership in reviewing the current insurance liability status."

So there is a lot of support for these public hearings, Mr. Chairman, and I compliment you on it.

Womack Boat Sales is a very small business. He has difficulty getting insurance, and he may have to go "bare." Carroll County Abstract & Title Co. is going "bare" because of the cost of insurance. Ben Pierson's insurance went from $45,000 in 1985 to over $300,000 for 1986, yet their experience of losses for the last 10 to 30 years has been negligible. In 1984 they had no loss. In 1985 they had a very small loss.

In my State, here is a recent headline, a fight between the insurance industry and the trial lawyers over tort reform. Obviously, both are speaking very forcefully against each other.

What I will be listening for today is what, if any, responsibility any of these industries and these associations feel that they have, either through Federal or State legislation, to help the small business community.

I thank you, Mr. Chairman.

Chairman PICKLE. Do any other members have any statement to make?

[No response.]

The first panel, then, will consist of Mr. T. Lawrence Jones, Mr. J. Robert Hunter, Mr. Jeffrey Joseph, and Mr. Robert Habush. Will these four gentlemen come forward and take their position at the witness table?

The first witness will be T. Lawrence Jones, the former president of the American Insurance Association. He also is an old and dear friend of mine from my State and my city, and we are pleased to have you here, Mr. Jones.

Next will be Robert Hunter, president of the National Insurance Consumer Organization. Mr. Hunter.

Then Jeffrey Joseph, vice president of domestic policy of the U.S. Chamber of Commerce. Mr. Joseph.

And Mr. Habush, president-elect of the Association of Trial Lawyers of America.

We will first go to Mr. Lawrence Jones. You are recognized, Mr. Jones, for 5 minutes.

Incidentally, I say to you and all the other witnesses today that your entire statements will be included in the record. We regret that we are going to be rather limited for time. We will try not to cut anybody off, but we also will have to proceed as directly and as speedily as we can.

Mr. Jones.

STATEMENT OF T. LAWRENCE JONES, FORMER PRESIDENT, AMERICAN INSURANCE ASSOCIATION

Mr. JONES. Thank you very much, Mr. Chairman.

The expressed concern of this committee and other committees in the Congress is why are the prices going up so much on legal liability insurance, why is it hard to obtain certain coverages?

Let me point out in the first instance that we are only talking about legal liability types of coverages, ones based on court cases and liability rules, mostly commercial and professional. We are not talking about automobile insurance except for commercial automobile insurance. We are not talking about homeowners, where liability is only a part.

The prices are going up because awards in the courts are going up. Prices were depressed, and they are catching up to what they should have been. The rate of investment income is declining, not the amount, but the rate.

Why are policies hard to get in certain types of business? Because the awards and the threat of awards are increasing. Because there are expanding liability concepts, such as the fact that now a person can be held responsible for serving too much alcohol to a guest in his home.

There are changing conditions and attitudes. The public and the juries have changed substantially their attitudes toward people that are accused of driving drunk, those that are accused of child abuse, and there are particularly big awards in birth cases involving doctors. There it is very easy to develop a tremendous amount of sympathy, and the awards are proportionately higher.

Coverages are difficult to get because increased premiums require increased capital under our regulatory system. When it is difficult to get a proper premium, an adequate premium, then it is difficult to get additional capital.

To illustrate, our premiums went up basically 20 percent across the lines. Now, that does not correctly represent the situation because in commercial lines it went up over 70 percent, and in the personal lines it went up very little. But overall, the premium levels of the industry went up 20 percent, and this means that it was necessary under State regulations to have 20 percent more capital. That meant $12 billion more in capital.

Now, we are beginning to reach toward it because in 1985 we added $8 billion, so that is $8 billion of the $12 billion. So we end up with what we call a tight or restricted market. In other words, the companies are unable to meet their full demand for insurance coverage under State regulation, and thus they tend to make choices between the coverages they prefer rather than those which have more uncertainty and risk.

That is the particular point here, that uncertainty exists in what the ultimate liability will be under our legal liability system.

I know that a number of you have specific problems. Some of them you mentioned in your opening statements. But I will defer and wait until those questions are directed to us.

I hope, Mr. Chairman, that I have given an outline of the difficulties that have brought about substantial increases in premiums and have made it very difficult to get insurance policies in certain lines of insurance.

Thank you.

[The prepared statement follows:]

STATEMENT OF T. LAWRENCE JONES, AMERICAN INSURANCE ASSOCIATION

The American Insurance Association (AIA) is a trade association which represents 170 property and casualty insurance companies. The member companies of the Association provide the majority of the commercial liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the tort liability system and its impact on the property/casualty insurance industry.

Insurers are exhibiting neither panic nor irresponsibility by taking a conservative stance on writing certain lines of commercial liability coverage. Rather, they are being prudent in the face of unprecedented losses and a rapidly changing operating environment.

UNDERLYING CAUSES

The "insurance industry" is not monolithic. Even the largest companies have a small portion of the total market share in any single line of insurance. Individual insurers engaged in intense competition in the early 1980's in pursuit of the premium dollar in order to invest. Insurers were able to reduce the price of their product by balancing underwriting losses with investment income until 1984. Lower prices inure to the benefit of the policyholder.

Extraordinary losses experienced by insurers, particularly in commercial casualty lines, have forced insurers to raise premiums dramatically. These premium increases have clashed with the expectations of policyholders, causing hardship among some policyholder groups who rely on various lines of commercial liability coverage.

Many insurers have experienced such financial hardship that they have withdrawn from writing some of the lines of insurance they formerly wrote.

This is clearly the case insofar as specialty lines, such as day care centers, dram shop liquor liability, and, to some extent, municipalities are concerned. However, withdrawal from these lines of insurance is, in many instances, also generated by the reinsurance market, which itself has sustained massive financial losses from its U.S. operations.

Insurers and reinsurers are recognizing that pricing and underwriting expectations for many classes of commercial liability insurance have been rendered unreliable because of the unpredictability of future losses. Judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, mandated minimum levels of insurance in federal* and state laws, society's increasing expectation of recovering higher and higher amounts from some "deep pocket" for virtually every injury, have taken their toll on the predictability of losses.* These developments affect virtually all forms of commercial liability insurance, but they especially affect long-tail exposures where the insurer's (and reinsurers') policies can be invoked five, ten, or even twenty years after the policy was written.

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* Bus Regulatory Reform Act, Motor Carrier Act, Superfund, and the Resource Conservation and Recovery Act.

* -- Ayers v. Jackson Township (N.J., 1983) -- $15.6 million settlement for alleged waste site injuries.

-- Dietz v. Gray Brothers (Pa., 1984) -- $750,000 judgment for alleged waste site injuries.

-- In Re Agent Orange (N.Y., 1984) -- $180 million settlement for alleged defoliant injuries.

-- U.S. v. Olin (Ala., 1983) - $24 million settlement for alleged DDT disposal site injuries.

-- Piatt v. Independent Petrochemical (Mo., 1983) - $2.6 million judgment for alleged dioxin injuries.

-- LaPoint v. Hooker Chemical (N.Y., 1984) - $20 million settlement for alleged Love Canal waste site injuries.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable, virtual certainty. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second basic fundamental of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

Standard coverage for liability insurance originally applied to bodily injury or property damage "caused by accident". The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete, rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage - a collision of vehicles, a scaffold which broke, a roof which collapsed. "Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1970, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically in the past decade. The relationship between low level exposures to useful, but sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

The concept of accident as a single scenario involving one person causing another's harm has changed. Increasingly, recent tort law has applied traditional concepts of individual risk-placing causation and harm into the modern commercial context. The result is that certain communities, types of persons throughout the nation, or classes exposed to risk of harm through commercial enterprises have sought to redress their harm through the liability system and have sought to hold entire industries liable for the creation of public risks. New types of suits differ from traditional cases in that:

- Injuries are medically complex and have multiple causes, often resulting in the introduction of presumptions into the legal system,
- Injuries have been attributed to exposure over a lengthy period of time,
- Injuries have been applied to groups or classes of claimants,
- Defendants are often a small number of entities or businesses or whole industries involved in certain types of behavior.

The Deep Pockets Report, prepared by the Institute of Civil Justice in 1985, indicates awards differ among types of defendants. Awards against corporate defendants averaged over $120,000 as against awards for individual defendants of $18,500. Where injuries were the same, corporate defendants paid 30 percent more than individual defendants. Notably, governmental defendants, which 20 years ago were protected by the Doctrine of Sovereign Immunity, where subjected to an average award of $38,000.

Certain classes of additional defendants are perceived differently than in the past. The problem of drunk drivers causing an innocent third party's injury has resulted in the expansion of liability to include the provider of the alcohol. In the past, everyone understood that some risk was inherent in any vaccine. However, in recent times, law suits have proliferated against vaccine manufacturers.

Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. As stated in the *Villanova Law Review*:

- In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant-manufacturers without proof that those defendants made DES which caused the plaintiffs' injury. In *Sindell v. Abbott Laboratories* (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff.

> Subsequently, in Bichler v. Eli Lilly & Co. (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturer of DES which was based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly--the only defendant named in the suit--was the manufacturer of the DES that the plaintiff's mother had ingested.[1]

In both Sindell and Bichler, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Other judicial decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In Beshada v. Johns-Mansville Products Corp. (1982), a manufacturer of asbestos in the 1930's was found to have an obligation to warn of the dangers associated with asbestos products. The manufacturer was not permitted to prove that at the time in question it was not possible to determine the possible harmful affects of asbestos. Prior to this decision, under the state of the art defense, even in strict liability cases, no manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. This novel decision is a particularly significant finding for chemical product manufacturers because they may be held liable even in instances in which the harmful potential of the product was not discoverable at the time.

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[1] Villanova Law Review, Volume 28, No. 6, September, 1983, p. 1102-1104.

Rulings of this type dispense with a fundamental element of the tort system--proof that the defendant was responsible for the plaintiff's harm. Such rulings disrupt the reasonable expectations of both manufacturers and insurers concerning the limits of their liability.

Judicial misinterpretations of insurance policies designed to respond to limited types of pollution exposures have created additional concerns among insurers. Recent court decisions have expanded insurance coverage for cleanup of waste treatment, storage and disposal facilities beyond that which the liability policies were designed to provide. Insurers have lost confidence in the words and phrases of art which have been placed in pollution insurance contracts in order to exclude coverages which may be provided in other insurance policies or which may be properly excluded due to the unpredictable or potentially catastrophic nature of the exposures.

The Comprehensive General Liability (CGL) insurance policy is the instrument used to provide the vast majority of insurance protection for commercial entities from liability for bodily injury and property damage. The CGL insurance policy is a contract between the insurer and the insured in which the parties define both the risks covered by the insurance and those excluded from coverages. The premium charged by the insurance company relates directly to the frequency and severity of the risk that the company intends to insure. Courts have elected to misinterpret the insurance policy contract language in order to maximize insurance coverage for damages related to hazardous waste.

Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premium was ever collected. Specifically, we perceive a trend in court decisions that interpret our standard CGL policy to broaden the scope of intended coverage as follows:

- Narrowing the intent of the owned property exclusion to find liability for damage to an insured's property.[2]
- Overriding the scope of the pollution exclusion so that, for example, well contamination caused by seepage at a hazardous waste site that occurred over a 12 year period was found to be covered despite the policy requirement that coverage be afforded for only "sudden and accidental" pollution.[3]
- Converting the CGL's policy dollar limit per occurrence into a per claim dollar limit.[4]
- Setting aside the definitions of property damage and bodily injury so as to award speculative damages for the possibility of future harm.[5]

The possibility of similar misinterpretations leading to expansion of coverage in the commercial auto policy exists due to the inclusion of the category of damages for "environmental restoration" in the Motor Carrier Act. Many commercial auto insurers have reacted by excluding environmental restoration from their commercial auto policies.

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[2] See for example, Riehl v. Travelers Insurance Co., ___ F. Suppl. ___, Civil Action No. 83-0085 (W.D. Pa., August 13, 1984).

[3] See, for example, Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company, 186 N.J. Super. 156, 451 A.2D 990 (1982). Waste Management of Carolinas, Inc. v. Peerless Insurance Company, 323 S.E. 2D 726 (Court of Appeals of North Carolina, December 28, 1984).

[4] See Township of Jackson v. American Home et. al., Docket No. L-29236-8 (Law Div., August 31, 1984).

[5] Ayers et. al. v. Township of Jackson, 189 N.J. Super. 561 (Ocean County, April 5, 1983).

Concurrent with judicial misinterpretations of insurance contracts, rapidly expanding liability concepts, and the recent drain on insurance industry surplus, the Congress has created a series of expanded responsibilities for insurers and their policyholders by mandating evidence of financial responsibility in a series of recently enacted federal legislation. The Motor Carrier Act (1980) and the Bus Regulatory Reform Act (1982) have mandated large minimum insurance requirements for buses and trucks. In the case of a motor carrier transporting extra-hazardous substances or a bus with a seating capacity in excess of fifteen, the minimum requirement for insurance is $5 million per vehicle. Although the Resource Conservation Recovery Act was enacted in 1976, the final rule associated with the financial responsibility requirements for waste, treatment and storage facilities was promulgated in 1980. Those financial responsibility requirements have been phased-in over the last 5 years. An additional wave of financial responsibility requirements can be anticipated in association with the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. All of these requirements for evidence of financial responsibility have coincided with the insurance industry's underwriting losses beginning in 1979.

INSURER OPERATING RESULTS

In order to put the present liability insurance problems in perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1980, losses and expenses have exceeded premiums primarily because prices failed to keep pace with loss costs. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983. An even more dramatic increase took place in 1984 when underwriting losses jumped $8 billion, reaching $21.3

billion. Losses from underwriting for the six years 1979 through 1984 totalled $55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income - the combination of investment income and underwriting results - plunged to a negative $3.8 billion in 1984. Operating losses for the first nine months of 1985 have exceeded $3.5 billion.

The commercial liability lines experience has been particularly negative. Four key commercial lines - general liability, commercial multi-peril, workers' compensation and commercial automobile - have suffered enormous underwriting losses. General liability leads all lines of insurance with the highest combined ratio of 152.

As a business, the industry cannot afford to indefinitely price its product at less than cost. As stated by the Insurance Services Office:[6]

> The decline in surplus and questions as to adequate loss reserves have raised concerns about the solvency of many insurers. In 1984, at least 22 property/casualty insurance companies were found to be financially impaired. Most of these companies were insolvent. Additionally, several sizable insurers were placed in rehabilitation by regulators with an indication given that liquidation could not be avoided. In total for 1984, companies accounting for more than one fifth of industry premiums failed 4 or more IRIS tests. As of mid-November 1985, 38 companies have become insolvent since the beginning of 1984. That is more insolvencies than in any full two-year period since guaranty funds were formed, and the books aren't yet closed for 1985.
>
> A.M. Best Company annually conducts a specialized financial analysis of most United States insurance companies and expresses its evaluation in the form of a rating. All companies rated "Excellent" are considered to be outstanding and have no material unfavorable variances from A.M. Best's averages. Lower ratings reflect increasingly unfavorable variances from A.M. Best's industry standards. An "Excellent" rating is considered essential if an

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[6] Financial Condition Of The Insurance Industry-An Update

insurer wishes to do business with top U.S. corporations, municipalities and government contractors.

From 1982 to 1983, 30 companies' ratings were upgraded to "Excellent" while 78 companies' ratings were downgraded from "Excellent". In 1984, there were 38 increases to "Excellent", but 150 companies received rating decreases from this level. When the 1985 ratings were issued, 25 companies had an increase in their rating while 331 companies saw their rating drop.

The declining solidity of the property/casualty industry is also illustrated by what is termed the exposure ratio, defined as the ratio of net written premiums to surplus. The percent of industry premiums written by companies with high exposure ratios has increased dramatically. The National Association of Insurance Commissioners (NAIC) has selected a premium-to-surplus ratio of 3-to-1 as a maximum. Any insurer writing above this level fails the premium-to-surplus test. While only 4 percent of the industry's premium was written by companies with a premium-to-surplus ratio above 3-to-1 in 1982, by 1984 that increased to 15 percent and estimates are that it will exceed 20 percent by the end of 1985.

While the financial results of the property and casualty insurance industry are partly the result of a competitive pricing cycle, the industry has also come to recognize that it has become a victim of fundamental changes in the civil justice system during the past decade. More and more, insurers have encountered court interpretations of prior insurance contracts which expand coverage beyond that which insurers intended. As a result, the availability and cost of insurance for current liability is significantly influenced by: insurers' concern about potential unanticipated past liability; the magnitude of potential liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; and a civil justice system that continues to create new theories of liability and to expand older theories.

VOLUNTARY SOLUTIONS

The American Insurance Association has thus far categorized pollution liability and asbestos abatement contractors' liability as falling into the unmanageable or uninsurable category. In addition, there are a number of availability problems in lines that are badly damaged by the liability system, but there is still a potential that insurers can provide coverage.* In these areas AIA will work actively with its companies, other trade associations and state insurance commissioners to explore voluntary Market Assistance Programs or other market solutions to the problem. A Market Assistance Program (MAP) establishes a central administrative point where a buyer who is experiencing difficulty in purchasing insurance may come in order to be referred to one or more participating insurers who employ their established underwriting criteria and rating plans. A MAP can also serve to gather information about real or perceived availability problems and be a focal point around which the insurance department, buyers' groups, agents and brokers may discuss availability problems in a constructive manner.

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* Day Care Centers, Liquor Liability, Directors and Officers, Physicians Malpractice Insurance, Nurse Midwives, Commercial Auto Insurance (Long Haul Trucking Companies and Bus Companies), Rural Homeowners Insurance.

In addition, the American Insurance Association would not oppose expansion of the application of the Risk Retention Act to troubled commercial casualty lines in which insurance consumers can demonstrate an existing availability or affordability problem.

It should be emphasized that merely shifting the burden from one insurance mechanism to another does not address the key problem associated with availability/affordability of liability insurance. Artificial, involuntary insurance mechanisms such as Joint Underwriting Associations mask the underlying problem. The answer to this dilemma has been and remains tort reform. There is a tendency among some regulators and legislators to adopt the expeditious approach of forcing insurers to write insurance coverage, either on an assigned risk or a pooled basis. This solves the immediate availability problem at no apparent cost to the public treasury and with no need to address the difficult task of reforming the tort liability system.

Structuring alternative insurance mechanisms addresses a symptom rather than the cause of the current commercial casualty insurance availability and affordability situation. Although alternative insurance mechanisms may be necessary in order to respond to federal and state financial responsibility requirements, a thorough review of common law decisions and state and federal statutory liability concepts is essential if commercial casualty insurance is to be both affordable and available in the future.

Chairman PICKLE. Thank you, Mr. Jones. We will return for questioning to you after we have completed the panel.

So now, Mr. Hunter, if you will proceed.

STATEMENT OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. HUNTER. On November 3, the Washington Post editorialized that liability insurance or the lack of it is becoming a national problem. The rates charged those in professions are rising rapidly. Local governments are finding it increasingly difficult or expensive to buy insurance, and because of the price placed on it, many small companies are dropping liability insurance.

They went on to say that there must be a limit to all this, that the real beneficiaries of this may be the lawyers, and there has to be a better way of compensating those to whom reparations are due than the clumsy and expensive mechanism that exists today.

That editorial was November 3, 1976, and that is my point. We are in a typical cyclical pattern of the insurance industry which is driving the prices skyward.

This is the insurance cycle. As you see on the chart attached to my testimony, typical bottoms were in 1965, 1975, and 1984. The period of the chart is roughly 10 years. This goes on and has gone on since the early 1900's in fairly consistent patterns.

During the cycle at the bottom there are sharp price increases. At the top there are sharp price decreases. In 1976 and 1977, prices rose by 20 percent. Last year in 1985 prices rose by 20 percent.

Between 1980 and 1983, prices for liability insurance were cut from $8 billion in the Nation to about $6.6 billion, hardly indicative of an industry facing a tort crisis in the early eighties. In fact, in the early eighties they were writing the MGM Grand Hotel fire after the fire, retroactive liability insurance. They lusted after the cash-flow for liability policies. When the interest rates dropped, they lost their lust.

Now, I was Federal insurance administrator during the last cycle bottom under President Ford. We undertook studies of the medical malpractice and product liability crisis, and we concluded that they were panic pricing by the insurers. Those studies are available in the public record. We think that is what is happening again.

Mr. GUARINI. What do you mean by consumer abuse? That seems like a characterization rather than an informative piece of information you are trying to give us.

Mr. HUNTER. Cancellations and massive price rises overnight are an abuse, and they occur at the cycle bottoms. In 1965 they occurred in the inner city in redlining of cities. In 1975 they occurred to doctors and to product manufacturers and cities. Now we are in the same situation—I think that is abusive and could be controlled.

Mr. GUARINI. Thank you.

Mr. HUNTER. Obviously, rates are excessive at some points on the cycle and inadequate on others. Every State has a law that says rates should be not excessive, not inadequate, or unfairly discriminatory. The States have failed to monitor adequately to control the cycle. It could be controlled.

Last year premiums were up $25 billion, over $100 for every man, woman, and child in the Nation when passed through by businesses as costs, and Wall Street has recognized that in the price of the stocks. A.M. Best keeps a record of the stocks of the property casualty industry. The property casualty stock index of A.M. Best & Co. went up 50 percent last year. It has risen at a rate five times the Dow Jones since they started keeping this index in 1969. It has made new high every year since 1978. Wall Street understands the cyclical nature of the industry.

Now, the insurers have blamed the availability problem on a tort law crisis. I don't see any tort law crisis in the aggregate. As a matter of fact, in Ontario, Canada, all the tort reform that is being proposed is already in place. There is about a $100,000 cap on pain and suffering, there are restrictions on punitive damages, almost unheard of, no contingency fees, juries don't decide, judges do, there are penalties for frivolous suits where if you lose, you pay the other guy's attorney, and yet in Ontario, Canada, the day care centers can't get insurance, all but one of 121 Canadian school boards can't get insurance, the city of Toronto can't get insurance, the Canadian national ski team can't get insurance and so on. The same crisis exists because it is driven by the cycle, not by the tort law.

Now, there are two situations. One is the crisis. That is driven by the cycle. The other is the tort law, and the tort law can be studied and should be. When I was Federal insurance administrator, I supported national no-fault auto insurance and I was successful in working with others to get both Presidents Ford and Carter to support national no-fault auto insurance. But we had before us the data necessary to make reasoned decisions.

We found, for example, that if you were hurt a little bit, you were overcompensated; if you were hurt a lot, you were undercompensated. So we didn't put caps on awards. That would have been ridiculous. What we did, in fact, was we limited the right to sue in our proposal but guaranteed the economic damages.

The kind of data necessary to find out about the tort law is in the company files. The insurers could produce it. It is not a complicated study. It's called a closed claim study. I encourage you to look at the Department of Transportation's study that led to the no-fault proposals. That kind of analysis is necessary before we move ahead to reduce the rights of American citizens.

Attached to my statement are insurance reforms at the Federal we would propose, and structural political-type tort reforms which we do support, limitations on both plaintiffs and lawyers' fees and the like. But where we draw the line is that without these analyses, you should not move to take away the rights of American citizens for their opportunity in court.

[The prepared statement follows:]

TESTIMONY OF

J. ROBERT HUNTER
PRESIDENT
NATIONAL INSURANCE CONSUMER ORGANIZATION

1. The insurance crisis is due primarily to the cyclical nature of the insurance industry.

Insurance companies cut their prices when interest rates, and thus their income from investing the premiums they collect, are high; they raise their prices when interest rates, and thus investment income, are low. They overreact at both the top and the bottom of the cycle. (See Chart 1.)

Wall Street understands the insurance industry cycle: while the price of insurance rises and falls, insurance stock prices just keep on rising. For example, since 1975 the property/casualty insurance stock index rose almost 500%, while the Dow Jones Industrial Average did not even double. And during 1985, as insurers complained of their dire financial condition, the property/casualty index rose by 50%, almost twice the rise in the Dow. (See Chart 2.)

2. The special privileges enjoyed by the insurance industry are largely responsible for the insurance cycle. For example:

A. The insurance industry is exempt from the antitrust laws. This allows insurance companies to agree to raise their prices without fear of antitrust prosecution. Executives in other industries who act in concert to raise prices can go to jail.

B. The insurance industry is exempt from federal regulation. In all other cases, when the federal government exempted an industry from the antitrust laws it substituted regulation for antitrust enforcement, as it did with trucking, railroads and utilities. The insurance industry is unique: that it is exempt from both antitrust enforcement and federal regulation, leaving the federal government impotent to deal with the dramatic price rises, mid-term cancellations and refusals to insure at any price so prevalent today.

C. The insurance industry is protected from competition by state regulation. Many state laws prohibit businesses, as well as consumers, from joining together to buy insurance at a lower rate, and state and federal laws prohibit other financial institutions from selling insurance.

D. The insurance industry is exempt from Federal Trade Commission scrutiny. In 1979, after the FTC published a study critical of the life insurance industry, Congress prohibited the FTC from ever again studying -- let alone prosecuting -- any sector of the industry.

3. The property/casualty insurance industry is exempt from federal taxation.

According to the General Accounting Office, the property/casualty insurance industry earned a profit of $75.2 billion during the period 1975-84, yet paid no federal income tax. The industry's tax exemption is due primarily to three insurance industry accounting privileges: the most significant such privilege is the provision allowing insurance companies to take a tax deduction for both the amount they pay out in the tax year and the amount they estimate they will pay out in the future. This amount is frequently wildly overestimated and consequently taxable income is substantially underestimated.

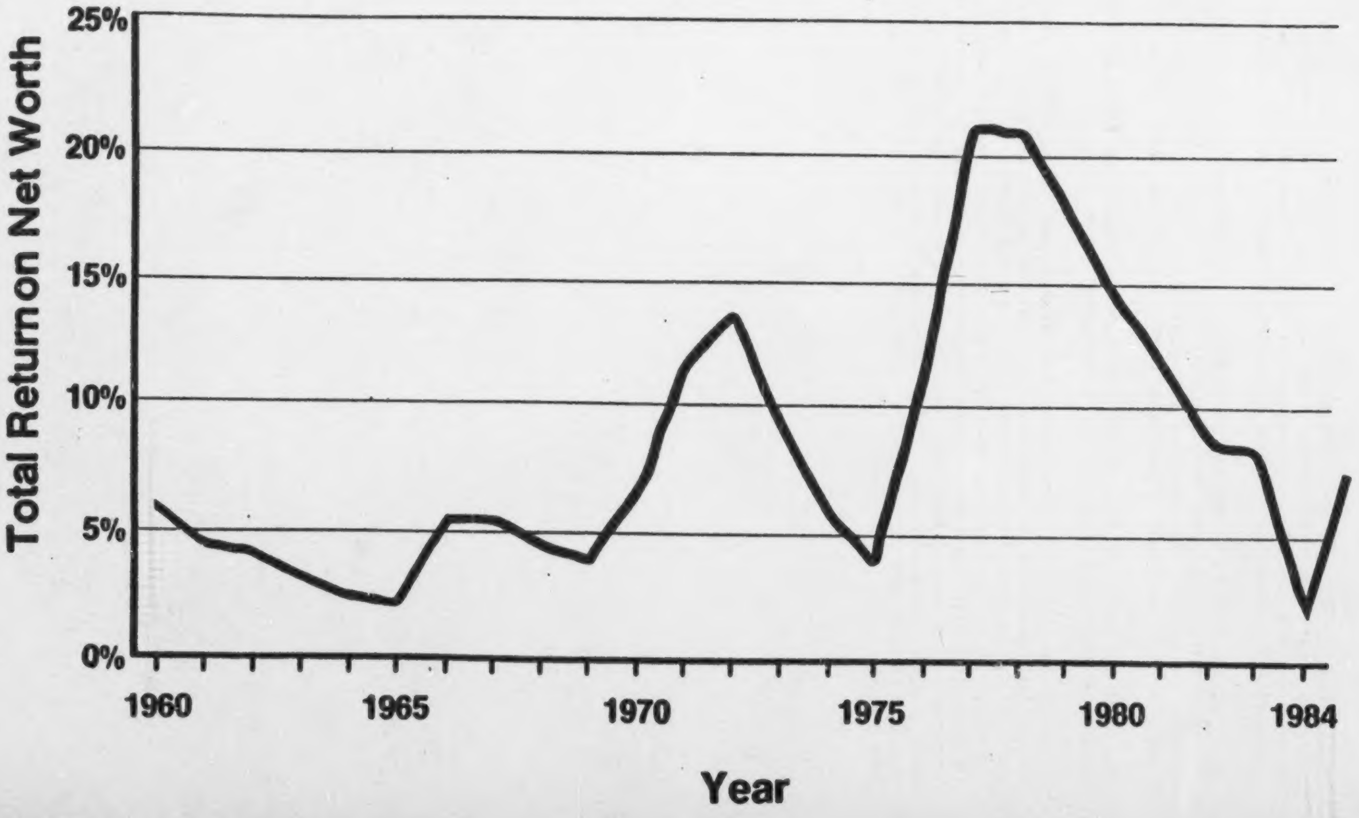
While the federal tax exemption for property/casualty insurance is not a direct cause of the insurance crisis, it does illustrate the extent to which the insurance industry is not subject to the same constraints to which other American businesses are subject.

4. The failure of the United States to regulate foreign reinsurance companies contributes to the insurance crisis.

Reinsurance is insurance for insurance companies: the insurer pays the reinsurer a premium and the reinsurer agrees to share the risk with the insurer. Most reinsurers are foreign. By far the dominant force in the reinsurance market is Lloyd's of London, which has dramatically raised the reinsurance premiums it charges many primary insurers and has pulled out entirely from many markets. It has also been racked by scandals. Because Lloyd's is not subject to federal regulation, American insurers have little recourse when Lloyd's raises its rates.

CHART 1

THE INSURANCE INDUSTRY CYCLE



HOW TO SOLVE THE INSURANCE CRISIS -- WHAT CONGRESS SHOULD DO

1. Subject the insurance industry to the anti-trust laws, thus preventing insurers from acting in concert to raise prices. Since 1944, the McCarran-Ferguson Act has allowed insurance companies to fix prices, while price-fixing in other industries is punishable by three years in jail.

2. Create a federal office of insurance to monitor the industry and establish standards for state regulators to follow. Although insurance is a national, $310 billion business, accounting for 12% of our gross national product -- more than any other item except food and housing -- only the states regulate the insurance industry. Because state insurance commissions are often under-staffed (half the states have no actuaries to analyze rate filings) and because state insurance commissioners typically come from and return to the industry, state regulation has not always protected the public.

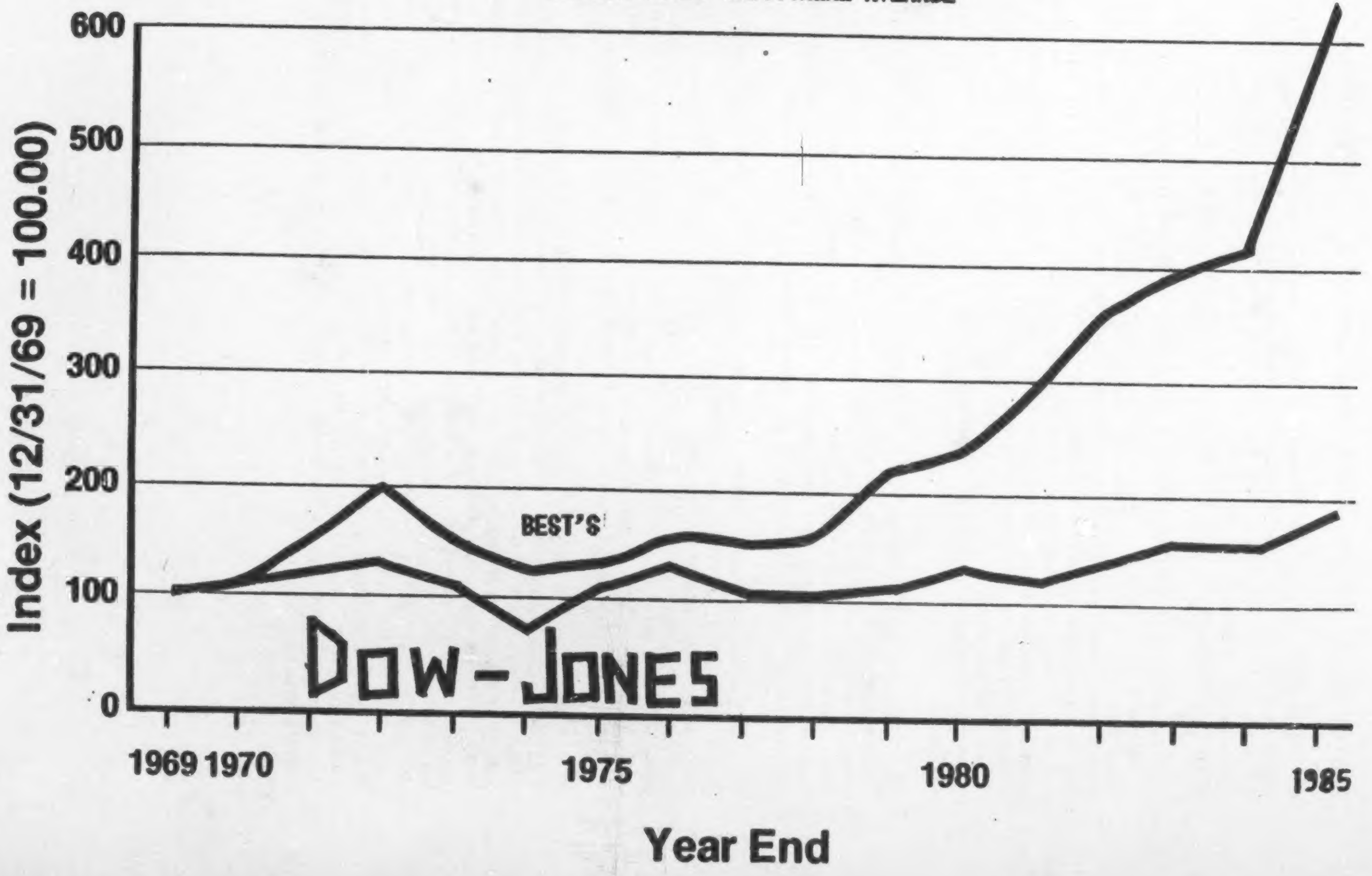
3. Repeal the insurance industry's exemption from Federal Trade Commission jurisdiction. In 1979, after the FTC published a study critical of the life insurance industry, Congress prohibited the FTC from ever again studying -- let alone prosecuting -- any sector of the industry. There is no principled justification for this exemption.

4. Expand the Risk Retention Act, which currently allows manufacturers -- but not other businesses, such as day care centers and nurse-midwives -- to join together to self-insure or to buy insurance at a lower rate. This would pre-empt state laws prohibiting such group buying. Automobile owners, for example, who must now buy insurance individually, could reduce their premiums by 10% a year by buying in groups.

5. Establish a national insurance industry-funded reinsurance program. Reinsurance is insurance for insurance companies: the insurer pays the reinsurer a premium, and the reinsurer agrees to share the risk with the insurer. Because the reinsurance market is dominated by Lloyds of London, which is not subject to federal regulation, US insurers have no effective recourse when Lloyds raises its rates, as it did in 1985. A US reinsurance program would compete with Lloyds and exert downward pressure on reinsurance rates, which in turn would enable insurers to reduce their rates. Congress established a similar program, which made a profit of $125 million, to reinsure insurers against riot-caused damages in the 1960's.

CHART 2

BEST'S PROPERTY/CASUALTY STOCK INDEX
V.
THE DOW-JONES INDUSTRIAL AVERAGE



HOW TO MAKE THE LEGAL SYSTEM MORE EFFICIENT

1. Limit defense lawyers' fees. Since 1956, defense lawyers' fees have risen almost three times as fast as the amount insurance companies pay to injured people, according to the National Association of Independent Insurers. Of the money spent by a corporation in a typical liability case, more money goes to the defense lawyer than to either the plaintiff's lawyer or the plaintiff himself.

2. Establish automatic, severe sanctions for frivolous motions, objections, and defenses. Because defense lawyers charge by the hour, they have an incentive to delay. To "keep their meters running," they may raise defenses, file motions, interpose objections and brief and rebrief the same issue — no matter how untenable their position — even if settling the case quickly would save their clients money. As long as there is no effective sanction for such tactics, defense lawyers will continue to delay — to the detriment of the legal system and often of their own clients.

3. Limit plaintiff's lawyers' contingency fees to one-third. Plaintiff's lawyers have no incentive to delay, since they get paid only if and when they win. And the contingency fee system is invaluable in allowing average people who could never afford to pay a lawyer by the hour their day in court. But if a lawyer will take a case only on a 40% or 50% basis then the case is too speculative and probably should not be brought. The traditional one-third contingency fee has worked well for both attorney and client and should not be exceeded.

4. Prohibit secrecy agreements. Defendants will often settle a case only if the plaintiff agrees never to disclose evidence in the case to any other plaintiff. Such agreements create more unnecessary work for defense lawyers and force plaintiff's lawyers to continually re-invent the wheel.

5. Expand the use of offensive collateral estoppel. Even when courts have already held a product to be defective, each plaintiff injured by that same product must re-prove that the product is defective. Again, this creates unnecessary delay and unnecessary work. It would be much more efficient to allow prior holdings that a product is defective or that a product has caused an injury to be used in other cases.

6. Transfer relatively small cases where the deterrent function of the tort system is less important into alternative, "no-fault" type systems. For example, in auto accident cases, where criminal penalties and the instinct toward self-preservation presumably deter negligent conduct, a well-structured no-fault system may compensate people more efficiently than the tort system without substantially lessening deterrence.

7. Increase the use of voluntary arbitration and mini-trials as alternatives to the tort system.

8. Transfer all inter-defendant disputes -- e.g., between a manufacturer and its insurance companies -- into an alternative dispute resolution system.

9. Establish nationwide and world wide service by mail to the greatest extent possible. With many corporations doing business through subsidiaries in all 50 states and throughout the world, service on a subsidiary should be service on the parent. Today, particularly when Japanese holding companies are defendents, it may take months just to perfect service.

10. As a prerequisite to any changes in the legal system, the insurance industry must agree that it will lower its rates by a specific amount if specific changes are enacted. Otherwise, such changes are futile.

Mr. GUARINI. Thank you very much, Mr. Hunter.

Now Mr. Joseph.

STATEMENT OF JEFFREY H. JOSEPH, VICE PRESIDENT OF DOMESTIC POLICY, U.S. CHAMBER OF COMMERCE

Mr. JOSEPH. Thank you, Mr. Chairman.

First a comment on some things Mr. Hunter said. I don't think there is any secret to the fact that there's a cycle in the insurance industry, just like there's a cycle in every industry.

I know that 10 years ago there were very serious problems starting to hit certain product manufacturers. I met earlier this morning with the board of the Sporting Goods Manufacturers who reminded me 10 years ago they came and met with me on their first visit to Washington to describe the need for product liability reform. At the time they were pushing State product liability reform, but they then saw the problem in the eyes of the law and legal system, not in terms of pricing by the insurance industry.

They tell me again this morning, they are even more convinced that the problem is a crisis in the civil justice system.

Now that is not something that I just heard firsthand this morning. We hear it every day at the Chamber. Every day for the past 6 weeks we have received about 400 to 500 surveys in from our members from all around the country. You can pull any batch of those, you can just go to the mail box and pull out any 20, 30, 40, 50 at random, you'll see what they say. They say that roughly 20 percent of them can't find insurance, liability insurance; over 40 percent of them have premium increases between 100 to 500 percent; nearly 10 percent have increases over 500 percent.

When you break down the figures, as we have, on an industry-by-industry basis, you find even more startling results. Manufacturing has had even a tougher time, according to those who have responded to us. One-third of the manufacturers who were surveyed cite their premium increasing between 100 and 500 percent, and 30 percent also have said they can't even get insurance.

Now that obviously has an impact on international competition. If they can make the products at an affordable price, they can't afford to sell them abroad.

Now an incredible 95 percent of these hundreds of people we are hearing from every day feel the problem is going to get worse before it gets better. We ask them, what do you think is the source of the problem, 93 percent say civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing; 96 percent believe the size of awards is excessive in relation to the economic costs arising from the injury, and 90 percent believe that the number and outcome of claims against businesses is unpredictable.

It has become apparent that the lack of affordable liability insurance and the lack of insurance altogether are largely the result of a more general liability crisis which manifests itself in many different ways. Our survey results indicate that the business community recognizes the cause-and-effect relationship, and while the lack of affordable insurance is certainly a very visible symptom of the crisis, there are others that are equally important. Other symptoms of the crisis include the explosion of lawsuits which characterize our legal system, the abandoning of certain products by manufacturers, decisions to file for bankruptcy by large corporations due to enormous liability exposure, and withdrawal from the medical, accounting, and engineering professions.

Now only when logic is incorporated into the civil justice system will some of these problems begin to correct themselves.

Now neither does awareness of the underlying inadequacies in our civil justice system imply that short-term solutions to the insurance crunch should not be pursued. We are encouraged that some States have successfully initiated marketing assistance plans and have created pooling arrangements under the guidance of State regulatory agencies.

Similarly, we support the efforts of specialty trade associations to provide insurance coverage through programs they have developed for their members, as well as the efforts of some businesses to self-insure, but we recognize that these measures, like Band-Aids, are but stopgaps which provide some necessary relief in a time of great need. You can't plug all the holes in a judicial system gone berserk. The notion of compensation without fault encourages actions against unidentified defendants and so-called deep pocket defendants, namely businesses, utilities, cities and counties, which often become defendants in lawsuits because they can afford to pay or have insurance rather than because they are at fault.

Tort and civil justice reforms are critical to the solution of the crisis that American businesses, professionals, municipal and local governments face in obtaining and affording liability insurance.

Now the chamber is encouraged that there appears to be a genuine grassroots movement all across the country which supports reforming the judicial system. Coalitions are organized in about 40 different States now. The States are equally behind the curve in terms of having all the answers to the problems, but in those 40 different States, most of the items on the table deal with structural reforms to the legal system.

In some States there are things on the table that deal with the pricing and availability and practice of the insurance industry, but the general perspective coming out of the States is a focus on the legal system and shoring things up.

We have been trying to work with representatives from these coalitions in the various States. Over the last few weeks we have met with several thousand of them. We held six meetings simultaneously at the end of January, pulling about 1,200–1,300 people together. These coalition leaders from around the country, trying to get them to ascertain where there are commonalities of interest and what sort of common strategies can be pursued.

We did the same thing last week up in the Boston area with representatives from the New England area Chamber of Commerce groups, talking about what's doable in New England.

We are disappointed, though, here in Washington that not enough has been happening.

As I mentioned, the sporting industry people have been here for 10 straight years. They are here again, and I suspect some of you will be seeing them later in the week.

A failure of the Congress to pass a uniform product liability law has disappointed the business community for the last 5 years. We desire to see Congress pass such a bill as quickly as possible.

In conclusion, my statement has a number of specific legal reforms which we feel need to be addressed. They are not exclusively all you need to do, and when all is said and done, the solutions may only include some of them, but may include others that aren't there. But unless judicial reforms in the broadest sense are considered, both here and at the State level, the crisis will not go away for quite some time.

Thank you.

[The prepared statement follows:]

STATEMENT
on
LIABILITY INSURANCE
before the
SUBCOMMITTEE ON OVERSIGHT
of the
COMMITTEE ON WAYS AND MEANS
for the
U. S. CHAMBER OF COMMERCE
by
Jeffrey H. Joseph
March 13, 1986

I am Jeffrey H. Joseph, Vice President of Domestic Policy of the U. S. Chamber of Commerce. I am appearing on behalf of the U. S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. I am grateful for the opportunity to testify on the availability of insurance, which is a matter of enormous concern to the business community. It is a pleasure for me to be here.

An unprecedented liability crisis in this country threatens the vitality of American business and the health of our national economy, as well as certain fundamental social objectives. While the present insurance crunch causes severe hardship for businesses, professionals, and local governments, it shows no signs of abatement. Small businesses are suffering especially. They are unable to self-insure, set up captives, or exercise other options that are available to larger companies. Neither do they have the bargaining power to negotiate a more favorable deal with insurance underwriters.

Recognizing this need, the Chamber's Council of Small Business called for the formation of an "Emergency Task Force on the Liability Crisis." Acting on the Task Force's recommendation, the Chamber's Board of Directors authorized the Chamber to initiate a broadly established public awareness campaign, to educate the public on the causes of the present crisis, and to seek solutions to the problem of obtaining affordable insurance. A listing of other Chamber activities on the "liability crisis" is attached to the end of my testimony.

We all have heard by now more horror stories than we wish to recount on how this liability crisis has affected various segments of the American economy. As information has been pouring into "The U.S. Chamber's National Clearinghouse on the Liability Crisis," we can begin to understand the scope and depth of this crisis. We now know that the these horror stories are not isolated and "anecdotal" and that entire industries have suffered.

Perhaps, the most important information gathered by the Clearinghouse to date has been the preliminary results of a "Business Liability Survey." The Chamber, through its Clearinghouse, has undertaken an extensive survey of its members to determine the impact of higher premiums and in some cases lower coverage in their liability insurance policies. The survey is an ongoing process, and additional responses are anticipated; however, we do not anticipate that the findings will change significantly.

Allow me to share with you some of the highlights of our survey. First, the survey of U.S. Chamber members indicates that businesses in every region of the country have experienced hardship in obtaining affordable insurance. We have found that almost 20 percent of the businesses surveyed have not been able to obtain or renew their liability coverage. We believe that when almost one of every five businesses cannot obtain liability insurance, there is genuine cause for alarm.

Overall, over 40 percent have had premium increases of between 100 to 500 percent, and nearly 10 percent had increases of over 500 percent. General liability coverage presents the greatest problem (60%), followed closely by product (40%), officer and director (31%), and transportation (30%). Nearly 35% are considering "going bare" -- operating their businesses without any liability coverage at all.

Unfortunately, an incredible 95% believe the problem will become worse.

The survey continues by exploring opinions on the current state of the civil justice system. When asked why they believe the number of liability suits and damage awards is increasing, 93 percent said the civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing. Ninety-six percent believe the size of awards is excessive in relation to the economic costs arising from injury, and 90 percent believe the number and outcome of claims against their businesses are unpredictable.

The final question we asked is "which of the following approaches should the Chamber of Commerce pursue concerning this problem?" The answers were: 39 percent for civil justice reform; 63 percent for federal product liability legislation; 23 percent for tort reform; 42 percent for changes in insurance laws; and nearly 48 percent for all of the above. Interestingly, the last choice was "no action," and only one person checked that response.

These survey findings confirm in greater detail the recommendations from the state meetings preceding the White House Conference on Small Business. Two of the three leading recommendations concern this issue. The number one recommendation of the first 27 state meetings is tort reform, and product liability reform is the third leading recommendation.

But the figures are even more dramatic when we consider them on an industry-by-industry basis. The percentage of those not being able to obtain insurance is much higher in the manufacturing industry, where it is an astounding 30%. One-third of the manufacturers responding to the survey state that insurance premiums have increased between 100 and 500 percent. As a result, one-third of the manufacturers responding believe the higher premiums have led to decreased profits.

In the transportation service industry, almost one-third of the respondents claim to have increased prices as a result of the insurance crunch. At a time of great distress for agricultural producers, over 40% will have experienced decreased profits as a result of this crisis.

Likewise, over one-third of petroleum producers responded that premium price increases have led to decreased profits for their firms. One-fifth of all retailers responding say they are dropping products or services as a result of the inability to obtain insurance.

It has become apparent that the lack of affordable liability insurance and the lack of insurance altogether are largely the result of a more general "liability crisis," which manifests itself in many different ways. Our survey results indicate that the public recognizes this cause-and-effect relationship. And, while the lack of affordable insurance is certainly a very visible symptom of this crisis, there are others that are equally important. Other symptoms of the liability crisis include the explosion of law suits, which characterize our legal system, the abandoning of certain products by manufacturers, decisions to file for bankruptcy by large corporations due to enormous liability exposure, and withdrawal by many from medical, accounting, and engineering professions.

I mention these other symptoms of the liability crisis not to diminish the magnitude of the insurance crunch, for surely this is alone potentially crippling. But, even if liability insurance were somehow magically made available to all those who wanted it, the corporate bankruptcies would continue, product prices would increase, and professionals would flee from their chosen professions under the threat of a system that is increasingly encouraging litigation and outrageous awards Only when logic is incorporated into the civil justice system will some of these problems begin to correct themselves.

Neither does awareness of the underlying inadequacies of our judicial system imply that short-term solutions to the insurance crunch should not be pursued. Although we recognize the enormous need for changes in our civil justice system, we should encourage insurance underwriters, as well as the state regulating bodies that traditionally have guided the industry, to develop programs that would ensure that all types of businesses have access to liability insurance coverage. We are encouraged that some states successfully have initiated "marketing assistance plans" and have created pooling arrangements under the guidance of state regulatory agencies. Similarly, we support the efforts of specialty trade associations to provide insurance coverage through programs that they have developed for their members, as well as the efforts of some businesses to self-insure or set up "captives." Legislation has recently been introduced in the Senate which would expand the scope of the "Risk Retention Act" which was signed into law a few years ago. The Chamber's policymaking committees are presently studying these proposals.

However, we also recognize that these measures, like band-aids, are but stop gaps, which provide some necessary relief in a time of great need. But they cannot plug all the holes that a judicial system gone berserk has created. The notion of "compensation without fault" encourages actions against "unidentified defendants" and "deep pockets defendants" -- i.e., businesses, utilities, cities and counties -- which often become defendants in law suits because they can afford to pay or have insurance rather than because they are at fault.

As a consequence of the public expecting all damages to be paid by someone, regardless of fault, businesses in every sector of the economy stand as a ready source of revenue in many cases for accident victims regardless of fault. A clear example are state dram shop laws, which hold restaurants liable for injuries that result from serving beverage alcohol. These laws are confusing and ambiguous. As a result of increased exposure to liability, without affordable insurance, many business men and women have closed rather than face a bankrupting frivolous law suit.

Tort and civil justice reforms are critical to the solution of the crisis that American businesses, professionals, municipal, and local governments face in obtaining and affording liability insurance. And there can be no substitute for enacting needed judicial reforms, which would better enable insurance underwriters to predict the exposure to risk on which they base their rate-making. The often cited product liability horror stories of which we are so familiar, where plaintiffs recover enormous sums based on jury sympathy or doctrines of deep pocket and strict liability, lead us to ask if it is any wonder that insurers are unwilling to offer coverage for activities for which they cannot predict the risk?

The Chamber is encouraged that there appears to be a genuine grass-roots movement across the country that supports reforming our judicial system. Over one thousand business representatives met simultaneously in town hall-type meetings sponsored by the Chamber in six cities last month. They learned from one another that their businesses were not alone in facing this liability crisis. Neither are they alone in seeking solutions. We know, through information submitted to the Chamber's Clearinghouse, that over half of the states have strong and growing coalitions seeking reform of our judicial system. We applaud the formation of such organizations, and it is our hope that they can benefit by working closely with the Chamber's Clearinghouse. Within the next week, we will make available a listing of these coalitions to interested individuals and businesses that wish to join in this effort.

Creating a climate that would allow changes in the judicial system to occur is the goal of the Civil Justice Action Group and of coalitions working with it. Changes in our judicial system urgently are needed at both the federal and state levels of government. Although we are encouraged that Congress is holding these hearings on insurance availability, we previously have expressed our disappointment over the failure of Congress to pass the "Product Liability Act" last spring. A uniform federal product liability bill would go far in alleviating the present liability crisis which underlies the problem of insurance availability. We reemphasize our desire to see Congress pass a product liability bill as quickly as possible.

The Chamber also is working to foster state tort reform with respect to medical professional liability. As it applies to health professionals and institutions, the present civil justice system is threatening the quality, availability, and affordability of health care in the United States. Our poll of Nation's Business readers recently released reveals a broad consensus that everyone is ill-served by the medical liability system. In June of 1985 our Board approved a medical tort reform program, including state action to cap awards for noneconomic losses, require coordination of payments from multiple sources, pay large awards over time rather than in lump sum, and encourage filing of law suits within a manageable time after the discovery of alleged malpractices. The complete text of our position statement is attached.

The Chamber enacted policy in February that recognizes the need for judicial reform, as well as the cause-and-effect relationship between the inadequacy in our court system and the availability of insurance.

It recognizes that, in recent years, there has been an explosion of litigation, especially tort litigation, in the United States that threatens fundamental judicial objectives of deterrence and redress. Courts have consistently redefined substantive and procedural law to permit easier recovery of larger and larger amounts of damages, which often have little relationship to the economic loss suffered. This has created a patchwork of inconsistent and often contradictory state laws. Contingent legal fees are a powerful incentive for initiating and continuing litigation. Costs associated with litigation have escalated. Litigation has, in fact, become America's equivalent of a national lottery. In such an environment, the predictability that is required for profitable business operations and rational insurance rate setting has vanished. As a consequence, liability insurance has become unaffordable or unavailable to many businesses.

There is an urgent need to reexamine the premises of the litigation system. The business community, its chambers of commerce and trade and professional associations, must join together to restore rationality to the system so that it can operate more efficiently and fairly. Such a program of reform would, among other things:

- Develop uniform standards of liability that are consistent with the principle that those who are responsible for harm to the person or property of another should, to the extent of that responsibility, offset the harm they have done.
- Reform rules of damages, particularly as they relate to noneconomic loss and punitive damages.
- Provide for alternatives to lay determinations of complex medical, scientific, and technological issues.
- Develop fair and cost-effective alternative mechanisms to replace private litigation for dispute resolution.
- Reduce transaction costs by regulating contingent legal fees.

Unless needed judicial reforms are enacted, this crisis will reserve ultimately its harshest consequences for American consumers. When obstetricians withdraw from their profession, it is the quality of health care for all of us that suffers. When sporting goods manufacturers go overseas, it is the American worker who becomes unemployed. And when, as many businesses reported to the U.S. Chamber, firms increase prices primarily to cover rising insurance costs, it is all of us who will pay more.

In fact, consumers as well as businesses already are beginning to feel the effects of the liability crisis. A growing number of corporations in an attempt to limit liability are abandoning certain products and, thus, deprive consumers of the benefits of technological advances. Important vaccines, drugs, and medical equipment in the U.S. are becoming "endangered products." As a representative of Lederle Laboratories explained to a special Chamber liability crisis meeting in Chicago recently, they are the only maker of the oral polio vaccine. Two other companies have ceased production of the vaccine. Yet, this is but one example of a trend that the Chamber survey indicates could be much more far-reaching. Services that are being eliminated have no bounds, and many are considered essential. They include health care services, day care services, and transportation services for society's most dependent.

At the very least, we can expect consumer prices to increase as a result of skyrocketing insurance premiums. In the construction and contracting industry, almost one-half of the businesses responding to the Chamber's survey indicated "increased prices" as one effect the liability crisis has had on their firm. Almost one-third of the professionals responding indicated the same answer.

Mr. Chairman, therefore, we are very concerned about the detrimental effect this crisis portends, not just for business but for consumers as well. Based on information compiled in our Clearinghouse, it is difficult to imagine that either group could withstand extended periods of hardship, which they are undergoing now. We hope that the present groundswell of support for tort reform can be translated into laws enacted by Congress, as well as state legislatures.

Overall, we urge this Committee to seek solutions to the underlying problems within the judicial system so that the problems for American business and consumers, which I have outlined, will not become worse. Thank you for the consideration of our views -- I will be happy to respond to any questions.

ATTACHMENT 1

U.S. CHAMBER ACTIVITIES TO DATE

- August 24th - "It's Your Business" program on the "crowded courts."
- September, 1985 - Nation's Business poll on "medical malpractice reform."
- October 3rd - Council of Small Business meets and recommends the formation of an "Emergency Task Force on the Liability Crisis."
- October 24th - "Emergency Task Force on the Liability Crisis" meets and makes recommendations to the Board of Directors.
- November, 1985 - "The U.S. Chamber's National Clearinghouse on the Liability Crisis" is created.
- November, 1985 - Business Advocate cover story on the "liability crisis."
- November 13th - Board of Directors recommends the establishment of a "Civil Justice Action Group" and "public awareness" campaign.
- November 15th - Association executives meet with Chamber staff to promote association participation in future activities.
- November 18th - "Nation's Business Today" features interviews with business executives.
- November 24th - "It's Your Business" program on "medical malpractice liability."
- November 26th - Chamber hosts an association briefing on the "liability crisis."
- December, 1985 - "Small Business Journal" television program features a commentary on the "liability crisis."
- December 1st - "It's Your Business" program on "product liability."
- December 3rd - Government and Regulatory Affairs Committee addresses the product liability issue.
- December 3rd - Chamber testifies before the Senate Commerce Subcommittee on Business, Trade and Tourism.
- December 16th - "Steering Committee on the Liability Crisis" holds its first meeting.
- December 17th - "Ask Washington" program on the "liability crisis."
- December 17th - Chamber hosts a Washington corporate representatives briefing on the "liability crisis."
- January, 1986 - Clearinghouse publishes its first monthly newsletter on the "liability crisis."
- January, 1986 - Combined meeting of Washington corporate and trade association representatives.
- January 23rd - Chamber regional conferences on the "liability crisis."
- January 28th - "Steering Committee on the Liability Crisis" holds its second meeting.
- February, 1986 - Nation's Business cover story on the "liability crisis."
- February 4th - Chamber testifies before the House Committee on Energy and Commerce Subcommittee on Commerce, Transportation, and Tourism on the "liability crisis."
- February 19th - Chamber testifies before the Senate Committee on Commerce, Science and Transportation on the "liability crisis."
- February 20th - Chamber testifies before the Senate Small Business Committee on the "liability crisis."

- February, 1986 - "Civil Justice Action Group" to be selected.
- February 21, 1986 - Chamber testifies before Senate Judiciary Committee

PENDING U.S. CHAMBER ACTIVITIES

- March 25, 26, 1986 - Chamber "Civil Justice Action Group" will meet in Washington.

- April 30-May 1, 1986 - Chamber co-sponsorship of a "National Symposium on Civil Justice Issues," in cooperation with Fordham University Law School and the Insurance Information Institute.

ATTACHMENT 2

STATEMENT ON MEDICAL PROFESSIONAL LIABILITY REFORM

Why Should Business Have a Particular Interest In The Medical Professional Liability Problem?

Professional liability is no longer a problem facing just physicians and hospitals. Escalating numbers of claims and increases in the size of settlements and awards are pushing up health care costs and causing changes in the practice patterns of physicians. The changes ultimately affect society-at-large as higher costs are passed on in the form of higher fees and health insurance premiums. Equally important, access to some types of care, particularly complicated and high risk care, is restricted. The fact that medical professional liability problems are causing health care costs to rise is even more significant given the intensive efforts in the public and private sectors to contain health care costs.

Employers are, of course, well aware of the impact of rising expenses of employee group health care plans on their costs of doing business, and, thus, ultimately on their ability to compete. On the other hand, most employers may not be aware of the impact of medical professional liability on those health plan costs. In 1983, employers paid $65.3 billion in health insurance premiums for their employees. The impact of medical professional liability on these premiums, while difficult to measure precisely, is significant. Estimates of the impact range from $2 billion to as high as $14 billion or higher. Thus, a significant percentage of the employers health insurance premium may be attributable to "defensive medicine" (i.e. the ordering of additional tests and treatment procedures as a response to the increased risk of a professional liability claim) and increased professional liability insurance costs.

What Indications Are There Of An Increasing Professional Liability Problem?

Beginning in the early 1970s, there were sharp increases in the number and severity of professional liability actions filed against physicians, hospitals, and other providers of health care services. What followed in the mid-70s was a period of instability in the market for professional liability insurance. First, there were rapid premium increases and, next, a dramatic decrease in the number of commercial carriers offering professional liability coverage for physicians and hospitals. In an attempt to alleviate the "malpractice insurance crisis," a number of states enacted tort reform legislation and/or statutes designed to assure the availability of professional liability insurance (such as through creation of joint underwriting associations). In the meantime, many state medical societies created physicians-owned professional liability insurance companies, and became actively involved in risk management, medical disciplinary and educational efforts to minimize preventable incidents of negligence or "malpractice".

By the late 1970s, it appeared that these measures and others had been effective in resolving the problem of availability of professional liability insurance, as well as having some positive impact on the number and severity of claims filed. However, what was hoped to be a resolution to the problem now seems clearly to have been merely a temporary respite.

In the last several years there have been sizeable increases in the number and magnitude of claims filed, which have resulted in medical liability insurance premiums going as high as $100,000 in certain metropolitan areas. There is also growing concern that increased medical liability exposure for high risk medical specialties is causing some specialists to limit or even withdraw from their practices, thus reducing access to care.

In the last five years, physicians have experienced increased risk of incurring a claim as well as greater losses per claim. In 1979, according to St. Paul Insurance Company, physicians incurred malpractice claims at an average annual rate of 3.3 claims per 100 physicians compared with 16.2 claims per 100 physicians in 1983. The severity of losses has also increased substantially.

There is no evidence that physicians or hospitals are more negligent in their delivery of health care today than in the past. In fact, one of the effects of increased "defensive medicine" may have been to decrease the numbers and/or magnitude of medical errors. On the other hand the tort system has allowed adjudication of cases increasingly on the basis of adverse results whether or not negligence was clearly demonstrable.

Guides For Business In Helping To Resolve The Professional Liability Problem

Because increasing professional liability insurance premiums and defensive medicine add significantly to the overall cost of medical care, much of which is absorbed by businesses through increasing health care insurance premiums, business clearly has a vital stake in working toward a resolution of the problem. Since other sectors of the community, such as consumers, hospitals, physicians, unions, and the legal profession also have an interest in and a role to play in arriving at a fair and effective resolution of this problem, it may be that efforts to address the issue through health care coalitions will provide one very effective activity.

As a guide to dealing with the professional liability problem, the Chamber offers the following principles:

1. Medical professional liability problems are a concern to business, since they add unnecessary costs to the health care premiums paid by both employers and employees and may reduce access to care.

2. Local health care coalitions and other community organizations should be encouraged to work toward resolving the professional liability problem in their areas as one important method of reducing health care costs.

3. Efforts to resolve the professional liability problem must ensure:

   - speedy and efficient resolution of claims

   - fair and adequate compensation for injuries arising from medical negligence

   - a reasonable degree of protection from suits without merit so that access to care and costs of care are not negatively affected

4. Efforts to resolve the medical professional liability problem should include strengthened professional self-policing, risk management and peer review. Such efforts could be accomplished through public or private sector mandate and could include:

   - reporting of settlements and awards to the state medical board and to hospitals

   - establishing risk management programs in hospitals

   - medical staffs reviewing and recommending action relating to medical liability awards or settlements involving a staff physician (with the hospital then reporting to the state medical board)

   - encouraging hospitals to require and confirm information regarding the professional credentials and work history of physicians seeking staff privileges. Hospitals should keep records on current and former physician staff for purposes of reference checks and disciplinary proceedings.

5. The tort system, as a deterrent to negligence and as a method of recourse after negligence, is beneficial to society and should be retained. However, reforms to the system are necessary to assure that it provides expeditious, fair and reasonable compensation for injuries resulting from negligence.

6. Tort reform legislation should be enacted in the various states. One option which should be considered in order to encourage enactment of such state legislation is federal incentive legislation.

Examples of basic tort reform measures include:

- Limitation on Non-Economic Damages
  Damages for pain and suffering and mental anguish are a primary cause of exaggerated professional liability awards because such damages are difficult to ascertain and are often influenced by emotion. The Rand Corporation estimates potential savings of 5-19% of medical liability litigation costs if non-economic damages are capped.

- Structured Settlements and Awards
  Providing structured settlements with periodic payments over an injured claimant's lifetime will ensure that the money will be there when needed and reduce the cost of the award.

- Elimination of the Collateral Source Rule
  There should be modification of the collateral source rule to prevent double payments.

- Modification of Statutes of Limitation
  The time period in which a patient has the right to file suit against a physician for an alleged injury should provide a reasonable balance between fairness to the plaintiff and fairness to the defendant. Many states still have statutes that permit suits to be filed so many years after evidence relating to the alleged negligence is known that appropriate defenses to claims are impossible.

  For minors, the statute of limitations in many jurisdictions begins to run when a minor reaches the age of majority. Physicians who treat infants and children thus face potential liability for more than 18 years. The statute should provide a reasonable period to discover any injury and file a claim — perhaps to age six or eight — but not extend liability decades into the future.

Chairman PICKLE. Thank you, Mr. Joseph.
Now Mr. Habush.

STATEMENT OF ROBERT HABUSH, PRESIDENT-ELECT, ASSOCIATION OF TRIAL LAWYERS OF AMERICA

Mr. HABUSH. Mr. Chairman, members of the committee, I want to thank you for the opportunity to be here today. I represent 56,000 trial lawyers in the United States and Canada, but I'd like to believe that I, as well as you, represent the injured victims who have no lobby. They were unable to fly in this week as the National Association of Manufacturers was.

I think it is a mistake, Mr. Chairman, for the committee to think this is a lawyer problem or a trial lawyer-consumer problem. Last week a Coalition for Consumer Justice was formed which was formed to counter the insurance lobby, and they said, and I quote, in their press release:

> Through a well-orchestrated public relations and lobbying campaign, the insurance industry is perpetrating a phony crisis. The insurance industry's real goal is to limit our right to hold wrongdoers responsible for the permanent injuries they inflict.

Included in this coalition are such groups as Public Citizen, Consumer Federation of America, the Consumers Union, the United Steelworkers of America, the AFL-CIO Industrial Union Department, the National Council of Senior Citizens, the National Insurance Consumers Organization, and many others.

So it would be a mistake to assume that there aren't consumers interested in this issue who are pointing the finger at who we believe to be the responsible party for this entire crisis.

Has everybody in America, Mr. Chairman, suddenly become a bad risk? In one year was there such an explosion and epidemic of large verdicts and settlements that people can't get insurance?

The chairman and the committee should be aware that studies have been done which show that companies, businesses, day care centers that have never had any claims against them are suddenly without insurance.

A study in New Jersey showed that 97 percent of day care centers had no liability claim against them over the last 5-year period, and yet they are without insurance.

As Mr. Hunter said, provinces and States that have caps and restrictions on recovery have the same problem that States without recovery have.

The National Association of Independent Insurers, in a paper entitled "The Critical Year" has said, and I quote:

> The property casualty industry must accept the major responsibility for its current financial condition. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive.

The regional vice president of the American Insurance Association was quoted in November 1985 as saying that prices today are coming back to what they were in 1977 or 1978, when adjusted for inflation.

The Iowa insurance commissioner, president of the National Association of Insurance Commissioners said:

> Regulators cannot trust annual statements and quarterly financial data. We regulators will therefore need to get tougher and spend more time looking over companies' shoulders. We cannot tolerate falsification or deception on annual statements.

Members of this committee, what has happened across this country is that insurance companies, willy-nilly, have withdrawn insurance coverage from units, businesses, companies, day care centers and other organizations with absolutely no justification whatsoever, and as a convenient scapegoat they have blamed the civil justice system.

The Honorable James Florio, who is chair of the House Subcommittee on Commerce, Transportation and Tourism said in January of 1986:

> My subcommittee has not been provided with any data that proves that the broad scope of the insurance crisis is attributable in any way to run-away judges and juries.

And I quote to this committee a recent editorial in Business Week, March 10, 1986, which is hardly a lawyers' publication, in which they say: "The industry charge that more litigation and larger damage awards are the causes of its red ink is, at best, unproved."

And paraphrasing, Business Week goes on to say editorially, "There is a better way to deal with liability claims than restricting the right of an injured person's day in court."

Mr. Chairman and members of the committee, we want you to examine evidence, not rhetoric. You are going to hear a lot of rhetoric today. We, the Association of Trial Lawyers of America, are ready to provide you with studies on punitive damages, studies by the Rand Corp. of actual verdicts and settlements, not anecdotes, not horror stories, but evidence and facts.

We are prepared to submit to you studies that we have done and commissioned on the medical malpractice crisis and the causes of increase in the insurance premiums for physicians, and we urge you to get the evidence, we urge you to get the facts and don't listen to just rhetoric or arguments or inflammatory statements.

The truth is that the insurance industry has run amok, not the civil justice system; that dart-throwing underwriters who with fearing lawsuits that exist only in their minds have caused this crisis to occur. We wouldn't be here today if you didn't have all these hundreds and thousands of people who have been victimized themselves by the insurance industry.

Thank you, Mr. Chairman.

[The prepared statement follows:]

The Insurance Crisis

A Study In Deception

The Association of Trial Lawyers of America

Introduction

Across the country businesses, professions, organizations, and governmental units, among others, are crying out for radical changes to the civil justice system that are described as reforms. These suggested changes are restrictions on recoveries and attorneys' fees. The entire movement was precipitated by the conduct of the insurance industry, which made insurance both unavailable and unaffordable to thousands of insureds.

The insurance industry, in an effort to justify its conduct, blamed the civil justice system for its actions and advised the American public that unless there were serious cutbacks in the rights of injured people to recover damages, insurance would remain unavailable and unaffordable.

There have been several lonely voices in the wilderness, including legislators and lawmakers, that have attempted to inform the public that the problems currently facing the industry are due to its own mismanagement and the underpricing of insurance products.

There is an assumption that the property/casualty insurance industry has been and is in deep financial trouble and that the requested reforms are necessary to preserve an industry that is ill from the ravages of an out-of-control civil justice system.

An additional assumption is that recent premium increases and the unavailability of insurance is also due to the legal system. Both assumptions are completely false. The fact is that for the past several decades the insurance industry has generally done very well. Even in times of heavy underwriting losses due to inadequate premium prices, there were increases in overall assets and an adequate return on net worth. Moreover, it is clear that the insurance industry will do very well, indeed, in 1986 and that the property/casualty stocks on the stock market have become very attractive investments.

In December 1985, headlines across the country screamed, 'Underwriting Losses for Property/Casualty Industry Hit New Highs.' The statement was patently deceptive. Although it is true that due to the insurance companies' peculiar accounting methods the industry anticipated an underwriting loss, it is not true that the net profit after taxes would be a loss of $5.5 billion.

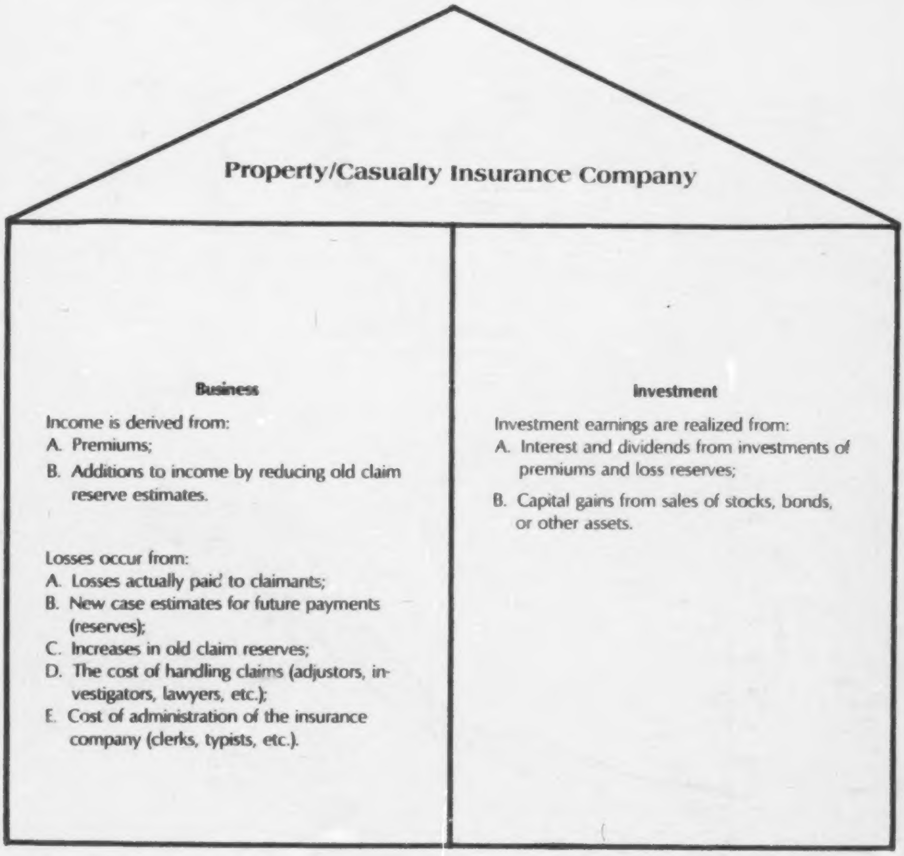
The truth and the fact is that for 1985 there should be a $1.7 billion net profit after taxes for the property/casualty industry. This was disclosed by the Insurance Information Institute after Ralph Nader and J. Robert Hunter, of the National Insurance Consumers' Organization, drew attention to the false predictions for [illegible]85. It is also true that if the estimated $2.1 billion in policyholder dividends is added back into income, the net profit after taxes for 1985 would be $3.8 billion--a far cry from the claim of a $5.5 billion loss (*Washington Post*, January 14, 1986, article by Sari Horwitz).

What is it about property/casualty insurance practices that are so mysterious and so misunderstood as to permit this massive deception of the American insurance-buying public?

In the discussion and illustrations which follow, the mystique will be pierced and the truth will become very clear: insurance company accounting methods, business practices, and cyclical influences—not the justice system—have been the cause of the recent crisis in the liability insurance marketplace.

The Insurance Company

In order to understand insurance company reserving practices, it is necessary to examine the structure of an insurance company.



Property/Casualty Insurance Company

Business

Income is derived from:
A. Premiums;
B. Additions to income by reducing old claim reserve estimates.

Losses occur from:
A. Losses actually paid to claimants;
B. New case estimates for future payments (reserves);
C. Increases in old claim reserves;
D. The cost of handling claims (adjustors, investigators, lawyers, etc.);
E. Cost of administration of the insurance company (clerks, typists, etc.).

Investment

Investment earnings are realized from:
A. Interest and dividends from investments of premiums and loss reserves;
B. Capital gains from sales of stocks, bonds, or other assets.

Assets of Property and Casualty Companies Have Grown Steadily in the Last 30 Years

Despite periodic complaints of hard times from the insurance industry, the facts are that the assets of the property and casualty insurance industry have grown from $22 billion in 1955 to $265 billion in 1984. Only once in that period of time (1974) did assets fail to increase annually. (Source—Insurance Information Institute (Charts A and B)).

Property and Casualty Assets

Year	Assets	Year	Assets	Year	Assets
1955	22,304,600	1965	41,842,900	1975	94,118,000
1956	23,106,000	1966	42,288,400	1976	112,975,000
1957	23,448,700	1967	46,561,700	1977	135,513,000
1958	26,308,600	1968	51,225,600	1978	149,097,000
1959	28,601,900	1969	52,368,800	1979	174,228,000
1960	30,132,400	1970	58,593,700	1980	197,661,000
1961	33,690,100	1971	67,284,400	1981	212,303,000
1962	34,216,800	1972	78,885,000	1982	231,693,000
1963	37,07[illegible]200	1973	83,862,400	1983	249,121,000
1964	39,864,800	1974	82,115,300	1984	264,735,000

Chart A

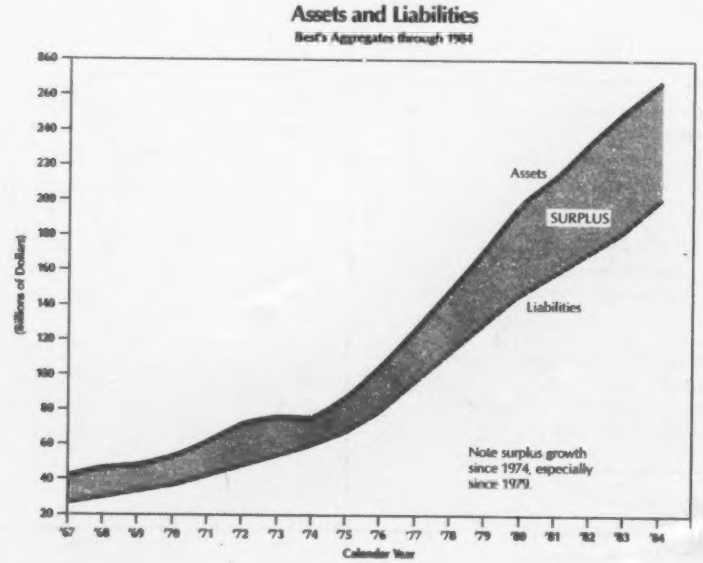


Chart B

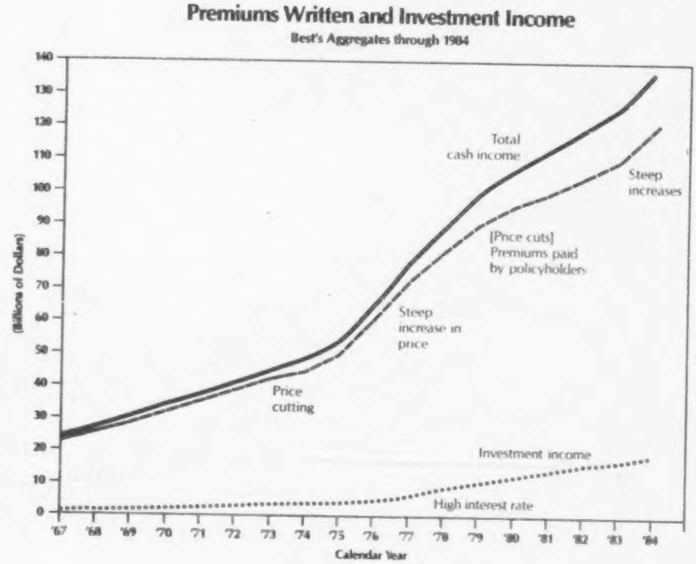


Chart C

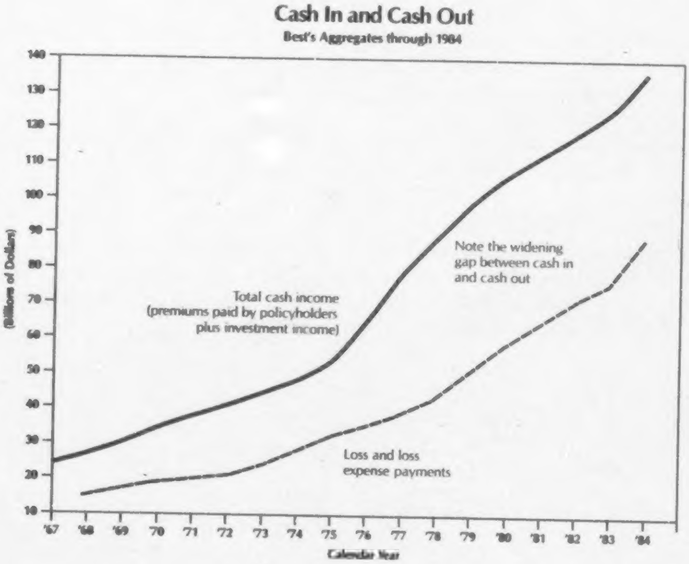
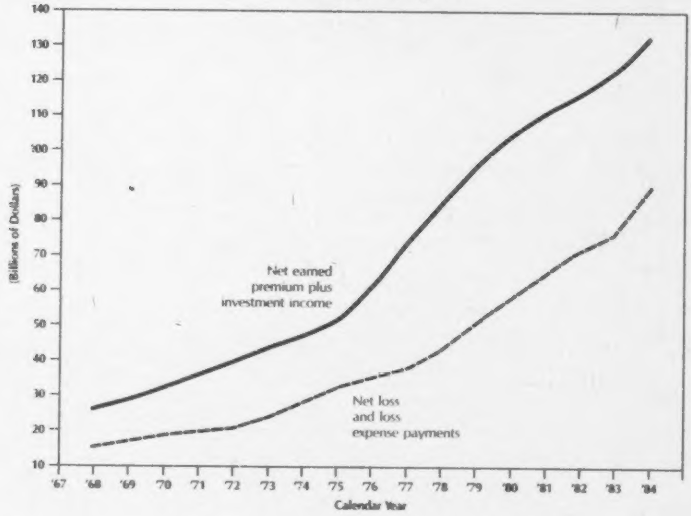


Chart D



Earned Premium and Loss Payments

Best's Aggregates through 1984

Chart C demonstrates how in the seventeen years from 1967 through 1984:

1. Investment income has steadily risen, although sharply increasing in the double-digit interest-rate years of the late 1970s and early 1980s, and leveling off in 1983 and 1984;
2. Premiums paid (price) by policyholders have continued upward in all of the seventeen years, but sharp price-cutting from 1973 through 1975 and from 1979 through 1982 are demonstrated by a leveling off of the line and a steep increase in price from 1983 thrugh 1984.

Both investment income **and** premiums income = total cash income.

The purpose of Chart D is to show the extent to which total cash income (premiums paid and investment income) **exceeds** losses and expenses related to losses (adjustors, investigators, lawyers, etc.). Note how the **gap** increases from 1975 on. The same relationship exists between **earned** premiums (always less than "written" or paid because earnings occur **during** premium **periods**—not all at once on payment) and loss expense payments (Chart E).

Loss Reserve Manipulation

The following facts concerning loss reserves are important:

1. Loss reserves are merely estimates of what **might** be paid in the **future** on **reported** claims. These reserves can be overestimated or underestimated.
2. When a loss reserve is established on the books, the effect is to charge current profits by that amount.
3. There is a reserve that is set periodically. That reserve is called the IBNR (incurred but not reported). This reserve charges current income for **suspected** losses that **no one** has even claimed against the company!
4. This estimating or reserving, as it is called, is vulnerable to great abuse and inaccuracy:
   a. If an insurance company desires to record greater profits, it can understate reserves.
   b. If an insurance company desires to shelter income or report larger operating losses to justify withdrawal of business from the marketplace or to justify huge rate increases, it can overestimate reserves.
5. When these reserves are examined in subsequent years, it is demonstrated that in many cases the reserves are overestimated and, thus, a greater loss was claimed than actually occurred.

It is important to reflect on the charges by the insurers that their sharp increases in premiums and total withdrawal from certain markets completely were due to the legal system, awards by juries, or big settlements. If that were true, one would see a close relationship between increased premiums and loss payments and reserves—that is to say, the so-called "runaway" tort system would be reflected in sharp loss payment increases or reserves. One has **never** heard insurers claim that awards and settlements have gone **down** so as to justify **lowering** reserve estimates!

Yet, the graphs that follow illustrate:

1. Loss payments have an infrequent relationship to increased premiums, and Chart F (premiums written and loss payments) **reveals sharp drops in loss payments (1975-1976) while prices (premiums) are going through the roof!**
2. Then from 1977 through 1979 prices (premiums) **drop like a rock** (price-cutting competition) **while loss payments actually increase!**

Again, loss payments drop off sharply from 1979 through 1983—during more price-cutting (1979-1981).

Conclusion: Prices charged are essentially a reflection of competition and a desire to put on business (downward line) or a desire to play catch-up, as in 1975 and 1983. Thus, there is little relationship to **loss payments or the tort system!**

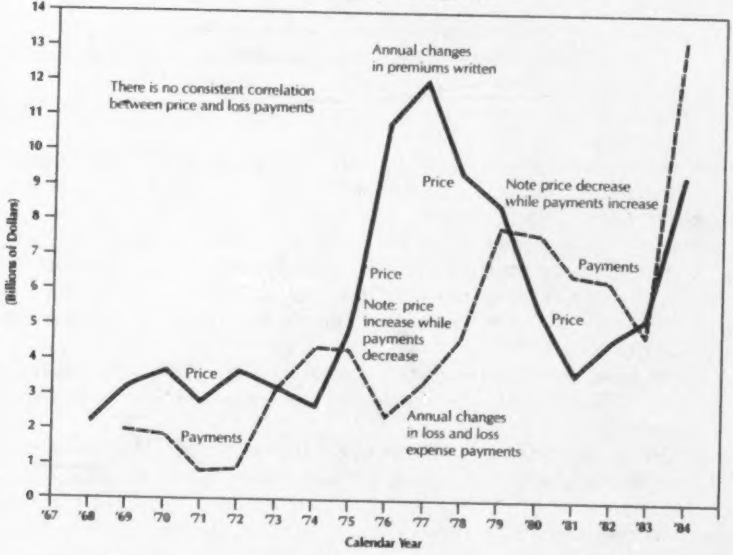


Chart F

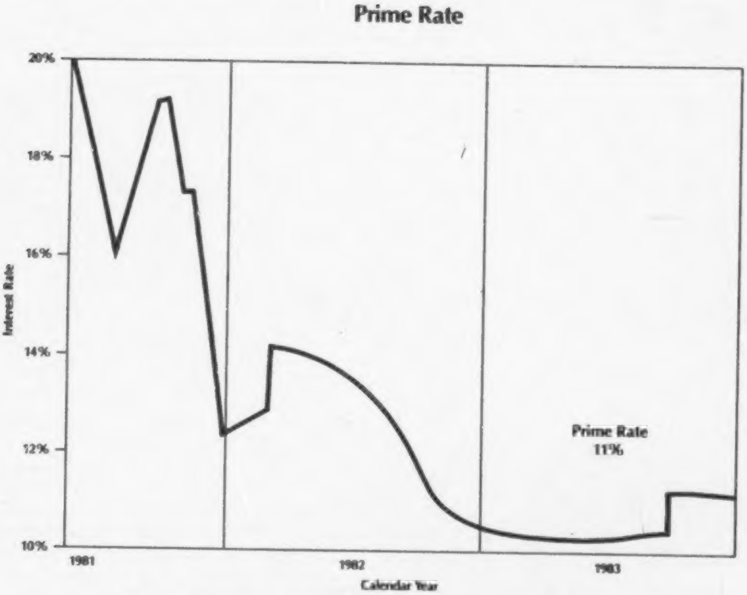
Reserve Changes May Be Influenced by Considerations Other Than Loss

Since the insurers claim their past financial reversals are all due to large verdicts and payments, we would expect loss reserves to continuously go up and up and up (the insurers' estimate of what they are going to have to pay on reported and unreported losses).

Remember, reserves are "guesstimates" and can be used not only to cover expected future payments, but also to shelter income so as to eliminate taxes! From 1974 through 1983 insurers paid federal income tax of only $1.3 billion (2 percent)—on reported profits of $72 billion! (Address by Natwar M. Gandhi, Group Director - Tax Policy, U.S. Government Accounting Office, August 20, 1985.)

Further proof that premium increases are not influenced by losses is found in this quote from *Best's,* the insurers' authoritative reporting and rating service:

> In 1984, insurance industry's own estimate of incurred loss and loss expense payments (reserves) **increased by the smallest amount since 1977. Yet at the same time as the rate of growth of losses was declining, premiums (price) increased by the largest margin since 1976, over 13%.** (Emphasis added.) (A. M. Best's Casualty Loss Reserve Development, 1985)



NOTE: The prime rate is currently 9.5%. As the chart above might indicate, property and casualty insurers have seen the income that can be earned on the investment of premium dollars cut in hope that investment income will rise to improve the corporate bottom line.

Chart G

If premiums (price) were, as claimed, a reflection of the underlying liability legal system, they would have **risen steadily over the years in line with inflation. This did not occur. Often the premiums plummeted or surged upward faster than inflation!**

Chart G shows why from 1977 through 1981 there was a scramble by insurers for market share to invest.

Premiums Written and Reserves
Best's Aggregates through 1984

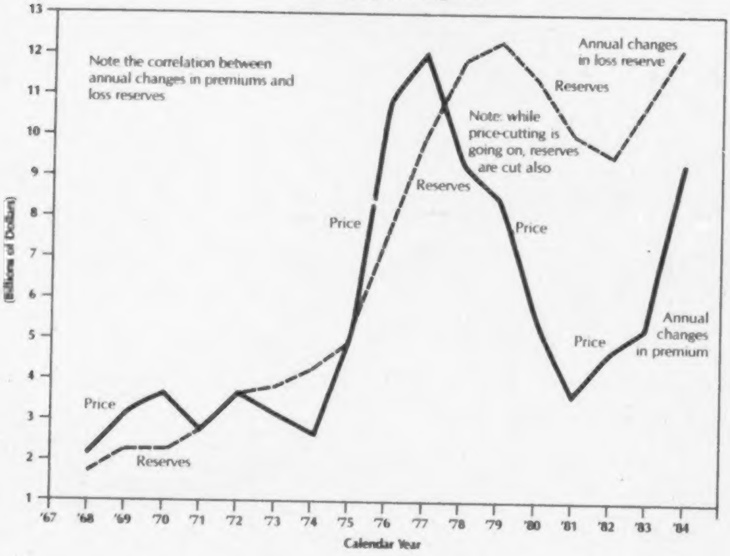
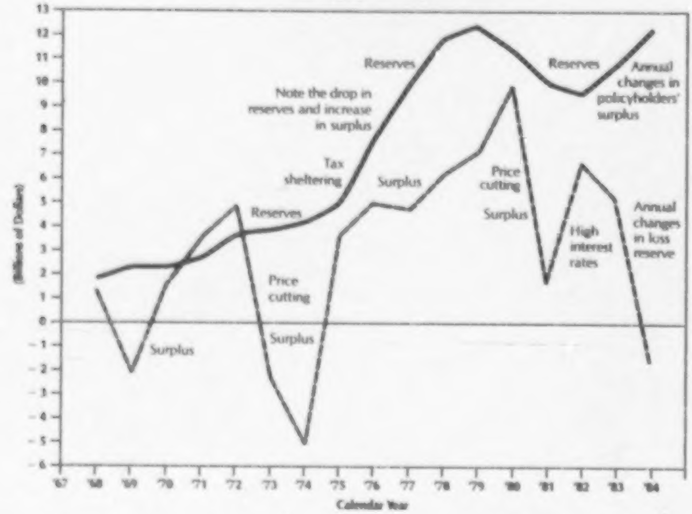


Chart H

Premiums Written and Reserves

Chart H presents dramatic evidence of reserve manipulation and refutes the lie that only the legal system **affects** income, reserving, and surplus. It can be seen in the time frame of 1977 through 1983 that the **price line** drops off sharply beginning in 1977 as the companies' lust for business causes them to cut prices (premiums). **Isn't it interesting that the reserve line drops sharply from 1979 through 1982—with all of this claimed "explosion" in settlements and jury verdicts in a society awash in "litigiousness"!**

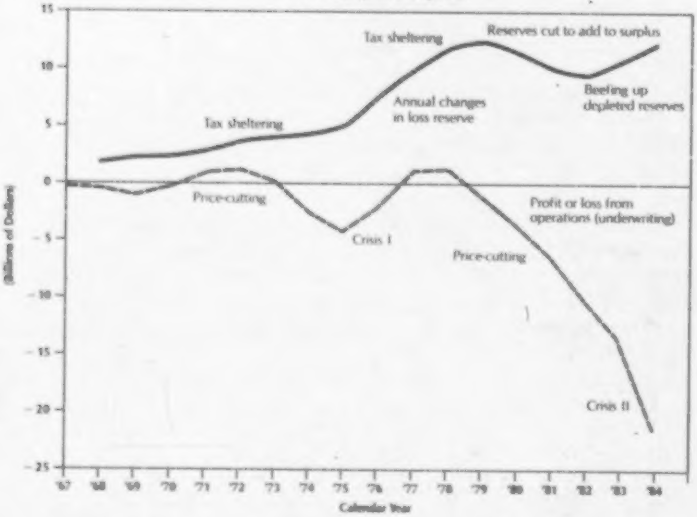
Why? How much business an insurer can put on the books is determined by a ratio of the "written premiums" to the surplus. If the insurer is putting a lot of new business on the books, it may be important to "beef up" surplus. The easiest way to do this is to drop reserves, because the amount cut goes into the surplus.



Policyholders' Surplus and Reserves

Best's Aggregates through 1984

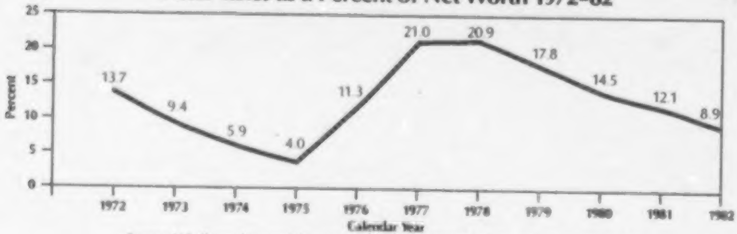
Chart I



Profit-Loss and Reserves

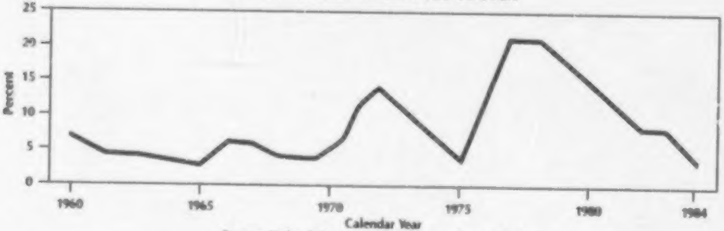
Best's Aggregates through 1984

Chart J



Average Annual Rates of Return on Net Income After Taxes as a Percent of Net Worth 1972–82

Source: U.S. General Acctg. Office GAO/GGD/83/10 3/25/85 p. 7, Property/Casualty Ins. Ind.



Total Return on Net Worth

Source: Citibank Economics & Insurance Service Offices

(Charts K and L)

Note on Chart I that the loss reserves drop in 1979 through 1982 and there is a sharp increase in surplus in 1979 through 1980 and again in 1981 through 1982.

In 1984 the insurers got "caught"—reserves previously depleted had to be beefed up and the surplus went down because investment income could not "carry" losses created due to the foolish price levels of 1977 through 1983.

Chart J shows the relationship between reserve manipulation and profit and loss. Some of the suspected "sheltering" is shown in the rise of the top line (loss reserves) while profits rose in 1977 and 1978. Again in 1979 through 1982 there was a loss reserve depletion during the period of price-cutting. The operational loss continued due to foolish pricing.

Despite all of these peaks and valleys, there still has been a return on net worth through 1984.

What Is Happening Now?

> "Companies are doing what they feel they have to to get back to price adequacy . . . competitive pressure drove rates down for many years. **Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation."** (Emphasis added.) (Grover Czech, Regional Vice President, American Insurance Association, *Pittsburgh Post Gazette*, November 8, 1985)

The National Association of Independent Insurers and Insurance Services Office, in *"1985, A Critical Year,"* concluded:

> **"The property/casualty industry must accept the major responsibility for its current financial condition."** (Emphasis added.)

However, do not mourn for the property/casualty industry. Michael E. Hogue, President of Philadelphia Insurance Research Group, at the convention of the National Association of Professional Insurance Agents, stated:

> "The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future." (*National Underwriter*, November 8, 1985)

It took Ralph Nader and the National Insurance Consumers' Organization, President J. Robert Hunter, to smoke out the truth about 1985 results. A gloomy prediction in December of 1985 of a $5 billion loss in the property/casualty industry was "suddenly" conceded to be a $1.7 billion net profit after taxes on January 9, 1986 (Sari Horwitz, *Washington Post*, January 14, 1986).

Best's reports:

> "In the first half of 1985, property/casualty stocks in Best's Index have advanced 30%, investor excitement being generated by a reasonable consensus that the longest industry down-cycle in history has finally turned, albeit by a small margin, they were rewarded on average by advances twice the size as those reaped by the general stock market."

Conclusion

The so-called "crisis" orchestrated and directed by the property/casualty insurance industry is intended to force legislators into curtailing the rights of consumers to recover damages when they become the victims of wrongful, negligent, and culpable conduct of others.

> "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures." ("Insurers Told: Exit Some Lines," *Journal of Commerce*, June 18, 1985; "Insurers' Profits to Zoom," *U.S.A. Today*, January 14, 1986)

It is obvious to anyone who will look at the evidence and not be influenced by common misconceptions about the legal system that the recent problems of price and availability are due to cycles of profit and loss caused by a desire for market share and over-reliance on investment income to cover business pricing mistakes.

> "I do not believe that there is a tort crisis across the nation. I believe we are witnessing joint action by insurers intended to create an atmosphere where rates can be put too high and legislators will be intimidated into action designed to take away victims' rights and to allow wrongdoers to be unpunished. It was no accident that A.H. Robins tried to piggyback onto federal tort 'reform' to be excused from its misdeeds." (J. Robert Hunter, President, National Insurance Consumers' Organization, before the Commissioner's Special Task Force on Property/Casualty Insurance, Eau Claire, Wisconsin, December 18, 1985)

Analysis of the *Best's* data repudiates any consistent relationship between reserving, loss payments, and premium levels and a claimed sudden increase in litigiousness or an increase in the number and size of claims.

In an authoritative study of litigation in the United States, University of Wisconsin Professor Marc Galanter completely exploded the myth that Americans file more civil lawsuits than citizens of other major industrial countries. A study of Federal Court filings from 1977 through 1983 showed no across-the-board increase in litigiousness. (31 *U.C.L.A. L. Review* (Oct. 1983); Administrative Office of the United States Courts (1984). See also, Stephen Daniels, Ph.D., "We're Not a Litigious Society: The Facts Do Not Support the Rhetoric Surrounding the Litigation Explosion," *The Judges' Journal* (Spring 1985).)

Similarly, a Rand Corporation study of jury verdicts in Cook County (Chicago), Illinois, revealed that when inflation is taken into account verdicts today are generally no higher than in 1960.

Two researchers from the Institute for Civil Justice of the Rand Corporation were quoted in the *National Law Journal*, November 11, 1985:

> "Our research shows that juries are usually sensible and that their decisions have been remarkably stable over 20 years."

The media report only the big, sensational awards and lawyers do likewise. Taking advantage of this erroneous perception of "litigiousness," the insurers have unfairly victimized insurance buyers and turned them on the legal system and lawyers as convenient scapegoats.

Insurance regulation is the answer. Disclosure and accountability are essential. Caps or limits on the recovery of victims will not avoid future arbitrary conduct by the insurers. Isn't it curious that liability insurance was unavailable to governmental units (cities, counties, villages, etc.) in states like Wisconsin, Pennsylvania, and Florida, which have had severe recovery limitations (caps) on personal injury awards in most cases for many years? The question answers itself.

It is time for lawmakers to hold insurance companies accountable for their behavior. No conscientious legislator should accept propaganda and biased conclusions from the insurance industry without requiring proof. To do so would be irresponsible and unconscionable. It is suggested that legislators consider the following reforms:

1. States should encourage the Federal government to be more pro-active in regulating the insurance business.
2. State law must require disclosure of loss data line-by-line, to provide regulators with valid information to discern whether rates are excessive, inadequate, or unfairly discriminatory. Line-by-line reporting will allow for adjustments between personal and commercial lines.
3. Insurance rates must be set based on the most current audited experience data.
4. Insurance regulators need better data verification, either by conducting their own frequent audits or using outside auditors. Loss reserves should be certified annually by an independent certified actuary.
5. Insurers must be required to fully disclose to regulators the total and accurate income earned through premiums and investments so that rate regulation can be valid.
6. State insurance commissioners and directors must be empowered by the legislatures to regulate, in a meaningful way, excess, surplus-line carriers and reinsurers, at least to the extent that the Federal government does not regulate them.
7. States need to establish their own reinsurance programs. A citizens' insurance board, modeled after the Citizens' Utility Board, should be established in the states, creating a citizen group to oversee the insurance industry in the same manner as is done with the utilities.

> "The basic factors leading to this hard market are well known. The soft market spawned a savage price war among insurers trying to increase market share and generate greater premium volume to take advantage of record interest rates." (Mariann Freedman, *Best's Review*, Property/Casualty Edition, February 1986)

The insurance crisis is a study in deception. Price gouging and unavailability of insurance have been perpetrated by the insurance industry upon the American public and when asked to provide a reason, the industry has blamed the civil justice system. This must stop. ■

Appendix

Best's Aggregates and Averages—1985 Edition—Data Through 1984

Year	Assets (1)	Liabilities (2)	Policyholders' Surplus (3)	Net Premiums Written (4)	Loss & LAE* Reserves (5)
1967	43,639,000,000	28,837,000,000	14,802,000,000	23,583,000,000	13,987,000,000
1968	48,084,000,000	31,892,000,000	16,192,000,000	25,766,000,000	15,747,000,000
1969	49,364,000,000	35,400,000,000	13,964,000,000	28,956,000,000	18,027,000,000
1970	55,315,000,000	39,816,000,000	15,499,000,000	32,578,000,000	20,256,000,000
1971	63,206,000,000	44,140,000,000	19,065,000,000	35,360,000,000	22,927,000,000
1972	74,235,000,000	50,423,000,000	23,812,000,000	38,930,000,000	26,609,000,000
1973	77,926,000,000	56,537,000,000	21,389,000,000	42,075,000,000	30,394,000,000
1974	76,976,000,000	60,256,000,000	16,270,000,000	44,704,000,000	34,574,000,000
1975	88,055,000,000	68,343,000,000	19,712,000,000	49,605,000,000	39,513,000,000
1976	105,586,000,000	80,956,000,000	24,631,000,000	60,439,000,000	47,105,000,000
1977	126,613,000,000	97,313,000,000	29,300,000,000	72,406,000,000	56,970,000,000
1978	149,097,000,000	113,718,000,000	35,379,000,000	81,699,000,000	68,767,000,000
1979	173,609,000,000	131,214,000,000	42,395,000,000	90,169,000,000	81,113,000,000
1980	197,678,000,000	145,504,000,000	52,174,000,000	95,702,000,000	92,493,000,000
1981	212,303,000,000	158,498,000,000	53,805,000,000	99,373,000,000	102,422,000,000
1982	231,693,000,000	171,298,000,000	60,395,000,000	104,038,000,000	111,959,000,000
1983	249,121,000,000	183,515,000,000	65,606,000,000	109,247,000,000	122,715,000,000
1984	264,735,000,000	200,925,000,000	63,809,000,000	118,591,000,000	134,926,000,000

Year	Net Investment Income (6)	UEPR** (7)	L & LAE* Ratio (8)	Net Premiums Earned (9)	Estimated Loss & LAE* Incurred (10)
1967	1,310,000,000	11,832,000,000	0.687		
1968	1,491,000,000	12,529,000,000	0.704	25,069,000,000	17,648,576,000
1969	1,686,000,000	13,618,000,000	0.722	27,867,000,000	20,119,974,000
1970	1,976,000,000	15,294,000,000	0.708	30,902,000,000	21,978,616,000
1971	2,309,000,000	16,435,000,000	0.675	34,219,000,000	23,097,825,000
1972	2,662,000,000	17,777,000,000	0.666	37,588,000,000	25,033,608,000
1973	3,094,000,000	18,944,000,000	0.693	40,908,000,000	28,349,244,000
1974	3,604,000,000	19,881,000,000	0.755	43,767,000,000	33,044,085,000
1975	3,905,000,000	21,529,000,000	0.793	47,957,000,000	38,029,901,000
1976	4,594,000,000	24,850,000,000	0.754	57,118,000,000	43,066,972,000
1977	3,816,000,000	28,387,000,000	0.707	68,869,000,000	48,690,383,000
1978	7,290,000,000	31,375,000,000	0.701	78,711,000,000	55,176,411,000
1979	9,279,000,000	34,585,000,000	0.731	86,959,000,000	63,567,029,000
1980	11,063,000,000	36,446,000,000	0.749	93,841,000,000	70,286,909,000
1981	13,248,000,000	37,816,000,000	0.768	98,003,000,000	75,266,304,000
1982	14,907,000,000	40,126,000,000	0.798	101,728,000,000	81,178,944,000
1983	15,973,000,000	42,450,000,000	0.815	106,923,000,000	87,142,245,000
1984	17,660,000,000	45,832,000,000	0.882	115,209,000,000	101,614,338,000

* Loss Adjustment Expense
** Unearned Premium

Year	Estimated Loss & LAE* Paid (11)	Change in Premiums Written (12)	Change in Loss & LAE* Reserve (13)	Change in Surplus (14)	Change in Loss & LAE* Paid (15)
1967					
1968	15,888,576,000	2,183,000,000	1,760,000,000	1,390,000,000	
1969	17,839,974,000	3,190,000,000	2,280,000,000	(2,228,000,000)	1,951,398,000
1970	19,649,616,000	3,622,000,000	2,229,000,000	1,535,000,000	1,809,642,000
1971	20,426,825,000	2,782,000,000	2,671,000,000	3,566,000,000	777,209,000
1972	21,351,608,000	3,570,000,000	3,682,000,000	4,747,000,000	924,783,000
1973	24,564,244,000	3,145,000,000	3,785,000,000	(2,423,000,000)	3,212,636,000
1974	28,864,085,000	2,629,000,000	4,180,000,000	(5,119,000,000)	4,299,841,000
1975	33,090,901,000	4,901,000,000	4,939,000,000	3,442,000,000	4,226,816,000
1976	35,474,972.000	10,834,000,000	7,592,000,000	4,919,000,000	2,384,071,000
1977	38,825,383,000	11,967,000,000	9,865,000,000	4,669,000,000	3,350,411,000
1978	43,379,411,000	9,293,000,000	11,797,000,000	6,079,000,000	4,554,028,000
1979	51,221,029,000	8,470,000,000	12,346,000,000	7,016,000,000	7,841,618,000
1980	58,906,909,000	5,533,000,000	11,380,000,000	9,779,000,000	7,685,880,000
1981	65,337,304,000	3,671,000,000	9,929,000,000	1,631,000,000	6,430,395,000
1982	71,641,944,000	4,665,000,000	9,537,000,000	6,590,000,000	6,304,640,000
1983	76,386,245,000	5,209.000,000	10,756,000,000	5,211,000,000	4,744,301,000
1984	89,403,338,000	9,344,000,000	12,211,000,000	(1,797,000,000)	13,017,093,000

Year	Net Premium Written Plus Investment Income (16)	Net Premium Earned Plus Investment Income (17)	Underwriting Gain/Loss (18)
1967	24,893,000,000		(254,000,000)
1968	27,257,000,000	26,560,000,000	(569,000,000)
1969	30,642,000,000	29,553,000,000	(1,048,000,000)
1970	34,554,000,000	32,878,000,000	(426,000,000)
1971	37,669,000,000	36,528,000,000	826,000,000
1972	41,592,000,000	40,250,000,000	(1,062,000,000)
1973	45,169,000,000	44,002,000,000	6,000,000
1974	48,308,000,000	47,371,000,000	(2,645,000,000)
1975	53,510,000,000	51,862,000,000	(4,227,000,000)
1976	65,033,000,000	61,712,000,000	(2,189,800,000)
1977	78,222.000,000	74,685,000,000	1,112,000,000
1978	88,989,000,000	86,001,000,000	(1,301,000,000)
1979	99,448,000,000	96,238,000,000	(1,301,000,000)
1980	106,765,000,000	104,904,000,000	(3,334,000,000)
1981	112,621,000,000	111,251,000,000	(6,288,000,000)
1982	118,945,000,000	116,635,000,000	(10,290,000,000)
1983	125,220,000,000	122,896,000,000	(13,322,000,000)
1984	136,251,000,000	132,869,000,000	(21,477,000,000)

* Loss Adjustment Expense

[NOTE.—Subsequent to the hearing, Mr. Habush submitted numerous papers and studies, some of which were referred to in testimony and subsequent questioning. All have been retained in the hearing files. A listing of those documents follows: (1) "The Role of Insurance in the Medical Malpractice Crisis," summary, Lilly & Associates; (2) Dr. Claude C. Lilly testimony before the Joint Committee, Feb. 26, 1986; (3) "Medical Malpractice: The Need for Disciplinary Reform, Not Tort Reform," Public Citizen Health Research Group Report; (4) "The Property/Casualty Insurance Industry: An Analysis," Robert F. Lowe, Casualty Actuaries, Inc., February 19, 1986; (5) "Jury-Verdict Statistics Misused, Trial Lawyers Assert," press release, Association of Trial Lawyers of America (ATLA), Dec. 9, 1985; (6) "Have You Heard the One About? . . . Here Is the Rest of the Story," press release, ATLA, Jan. 23, 1986; (7) "Punitive Damages: Storm on the Horizon?" Stephen Daniels, American Bar Foundation; (8) "Current Award Trends," Jury Verdict Research, Inc.; (9) Kent and Sussex County Delaware, tables and charts on damage claim filings; (10) "Civil Tort Study February 1986," Eleventh Judicial Circuit, Dade County, Florida; (11) Vasos, Kugler & Dickerson, Donald W. Vasos, letter enclosing statistics on greater Kansas City medical malpractice and product liability verdicts, Mar. 10, 1986; (12) "Punitive Damages Research," Max E. Goodwin, Indiana Trial Lawyers Association, Corp., 1986; (13) "The 'Nonexistant' Medical Malpractice Crisis in Kentucky," the Advocate, March 1986; (14) West Virginia State Bar, memorandum re medical malpractice cases and tort reform, Feb. 25, 1986; (15) "Study of Medical Negligence Cases Filed in King County Superior Court in 1982," Washington State Trial Lawyers Association, Jan. 24, 1986; (16) Dallas County, Texas, statistics and analyses of awards; (17) South Carolina Bar, memorandum re insurance statistics, Feb. 12, 1986; (18) New Hampshire statistics, memorandum, Leslie C. Nixon; (19) Maine questionnaire and statistics; and (20) Louisiana court statistics.]

Chairman PICKLE. Thank you very much, Mr. Habush.

You have been a very interesting panel. There is a representative of the American Insurance Association, the National Consumer Organization, the Chamber of Commerce, and the Association of Trial Lawyers. Your testimony is altogether different and even contradictory, except you all agree that we have a serious national problem on our hands.

We will now proceed with questions. I want to ask first as a matter of information for myself, Mr. Jones, if you will submit to our committee some information about the Insurance Services Office. We want to know what the ISO does, where they get the data, what are the most recent ISO data on premium pricing and that type of thing. We want to know how premiums are arrived at, and similar factual data. You do not need to go into that in detail now but we would like for you to submit that.

Mr. JONES. Mr. Pickle, don't you plan to have them as a witness later at the next hearing?

Chairman PICKLE. Yes; they are tentatively scheduled. Do you want them to speak for themselves?

Mr. JONES. Yes, they could. I would be happy to supply the information.

Chairman PICKLE. We will be happy to work with them. But we want that information either from you or them.

Mr. JONES. I will confirm with them whether they are coming or not. If not, we will certainly supply it.

[The following was subsequently received:]

MATERIAL REQUESTED BY CHAIRMAN PICKLE ON I.S.O., WHAT IT DOES, HOW IT DEVELOPS RATES, WHAT ARE ITS RATES

Insurance Services Office, Inc. (ISO) is a non-profit corporation serving property-casualty insurance companies in all fifty states, the District of Columbia and Puerto Rico. Typically, it is authorized to operate as a statistical agent, advisory organization and/or rating or a rate service organization.

ISO was formed as a voluntary association of property-casualty insurance companies in 1971 through the consolidation of many separate national, regional, and state service organizations or bureaus. It incorporated in 1982. Although ISO today performs many of the essential functions of the predecessor organizations, it operates in a manner so different from that of its historical antecedents that the term "bureau" is no longer appropriate. ISO has no mandatory membership requirements, nor does it have adherence requirements with respect to advisory rates, loss costs, policy forms or programs. In fact, it actively encourages independent action by participating insurance companies.

ISO's primary mission is to serve participating insurers by gathering, storing and disseminating statistical information to regulators–as required by law–and to insurers for their own use. It also develops and assists in implementing programs that help define and cover risk; and finally, it promulgates advisory rates or advisory prospective loss costs for sixteen different lines of insurance in the various jurisdictions.

Some of the specific services offered by ISO are as follows: It develops programs and coverage documents for possible use by insurers. These programs are designed to meet the minimum coverage requirements of the insurance marketplace. By drafting standardized documents it provides insurers with basic tools to help them define, price and deliver coverage economically.

It serves as a statistical agent which involves the development of statistical plans and the collection and compilation of statistical data from participating companies. The aggregate data are submitted to regulatory authorities, thereby fulfilling state requirements and providing statistics in a common format for regulatory use and review.

It also performs actuarial services which involve the preparation, review and analysis of statistical data to develop reasonable projections of rate level need, overall, by class and by territory. This results in either advisory rates or advisory prospective loss costs, which may or may not be filed with regulatory authorities in different jurisdictions depending upon the type of rating law or regulatory requirements. This information is also provided to participating insurers, each of whom may elect to use, modify or disregard that information depending upon their own needs or requirements.

Its wholly-owned, non-profit subsidiary, ISO Commercial Risk Services, Inc., conducts commercial property insurance rating surveys throughout most of the country to help establish specific building rates for fire insurance and other property coverages. The reports which are issued from these surveys give insurers a better picture of the rating conditions at the buildings they cover and therefore help individual insurers rate their risks more accurately.

It is important to appreciate the role that ISO plays in the property-casualty insurance industry today as contrasted with the historical view of "rating bureaus." Thirty years ago these bureaus were organized along local, regional and national lines. They specialized in either property or casualty insurance, for one or more lines of coverage. Collectively these bureaus came to be regarded as an insurance cartel. They were characterized by mandatory membership requirements, complete adherence to rates, rules and forms and full indivisible services. If a company was affiliated for one service it was affiliated for all of them. An affiliated insurer was required to use and to adhere to bureau programs and rates.

Those days are long gone. Indeed, the monolithic cartel had already virtually disappeared by the time Insurance Services Office was formed in 1971. From its inception, ISO has encouraged individual insurers to make their own rate level decisions. Significant changes in the regulation of insurance pricing have been occurring for over twenty years. Over half the states have joined California in turning away from strict prior approval rate regulation and in adopting less administerial forms of price regulation, at least for some lines of insurance. And the trend is continuing.

While these changes in the regulation of insurance pricing were evolving, the traditional bureaus were transformed into a modern advisory rating organization which can perform many necessary services more efficiently than individual firms. Indeed, in today's competitive environment, insurers will only participate in a rate service organization under two conditions: (1) where that organization performs functions which can best be performed collectively and (2) where economies of scale in certain collective activities enhance rather than diminish competition. This is why we view ISO's essential task to be the development of information which will assist participating insurers in the making of informed, intelligent and independent pricing decisions.

WHAT ARE ISO RATES?

There is a great deal of misunderstanding about ISO rates and the use of those rates by participating insurers. Insurers are not required to use ISO rates and ISO, as a matter of corporate policy, encourages companies to evaluate ISO's advisory rates in light of their own marketing and corporate goals.

ISO rates are average rates, developed from generally accepted actuarial formulas, utilizing the average loss and expense experience of its affiliated insurers. For every line in which ISO has jurisdiction, the ISO ratemaking formulas are designed to provide for the payment of losses, expenses and a reasonable provision for underwriting profit and contingencies. The provision for losses is determined by reviewing historical values of losses per unit of exposure for all ISO reporting carriers, and adjusting for trend and future conditions. The expenses provision is determined by reviewing historical values of expenses as percentages of the premium dollars for ISO carriers.

ISO rates are not designed to be "competitive" in the marketplace for specific targeted risks or insurers. Rather, our rates are designed for the company with average expenses to apply to the average risk, and obtain a reasonable underwriting profit. ISO's state-of-the-art rate-making techniques provide statistically sound average rates which companies can use as a benchmark in developing their own pricing and marketing strategies.

Why companies deviate from the ISO rate:

Different loss experience.—If its book of business has been better or worse than average on the loss side, a company can adjust manual rates accordingly.

Different expense experience.—If an insurer has lower than average expenses, it may charge rates lower than those ISO suggests.

Different profit needs.—ISO advisory rates include 5 percent for underwriting profit and contingencies. However, individual companies may have different profit targets and adjust the ISO advisory rates accordingly.

Production goals.—The growth goals of insurers vary. If an insurer is committed to growth in a particular market it may lower ISO's cost-based rates in order to attract new business.

Competition, however, more than any other reason, forced some insurers to lower prices and forgo underwriting profit to achieve their corporate goals. Others, while wishing to maintain cost based pricing, could not afford to lose renewal business and consequently, lowered their prices accordingly. Additionally, the reliance on investment income to offset underwriting losses increased dramatically, particularly in the long tail casualty lines.

Individual companies' competitive strategies, marketing considerations, growth and market share priorities and other factors all influence an insurers' perspective or judgment regarding the appropriate *price* to charge for a commercial risk. There is a very definite distinction between the price charged and the cost-based rate which does not reflect independent insurers' business strategies. However, ISO does provide companies with the underlying actuarial and statistical justification for its advisory rates so that companies can then make intelligent and fact-based business decisions.

Chairman PICKLE. Let me start first by saying, Mr. Jones, on page 12 of your testimony, you advocate that tort reforms is the exclusive solution to the current liability insurance problem. Can you elaborate on that? Exactly what type of tort reform measures would you advocate?

Mr. JONES. The tort reform that we would advocate and are advocating at the various States is to change the rule of joint and several liability to make it several. That permits insurance companies to appraise the risk of their particular policyholders. If it is a joint liability, we don't know what they are exposed to. If it is several liability, then we can appraise the risk they are exposed to.

We also advocate that there be a change in the collateral source rule, which in the past has prevented the showing in court of recoveries say from your health insurance or your employee benefits and has in some cases resulted in double recoveries. We advocate the change of that so that what you have received either from your health insurance or from the employee benefits is applied against any award that is made under the liability system and there be no subrogation of any such benefits that have been provided to you.

We urge that there be caps on noneconomic losses. I want to stress "noneconomic." We are not talking about limiting the economic loss of individuals but we are talking about noneconomic losses. Those are primarily punitive damages and what are called pain and suffering damages. In many cases these can far outweight those awards that are made for true economic loss.

Also we urge that there be a sliding scale on contingent fees for the claimant lawyers. One might wonder what benefit this would have in terms of cost. There is the feeling that some juries make allowances for what might be paid to the attorney and have increased their awards accordingly. Recently California did—they passed it in 1975, but it was recently upheld by the Supreme Court of the United States—passed a law putting the attorney fees on a sliding scale. I could give you those if you are interested in them.

In many instances, we think the idea of liability based on fault should be restored. More and more, the courts have gone to a concept of strict liability. There are some defenses under strict liability but then they have even gone to the point of absolute liability, which is really the standard that is being used in pollution liability and some other things that have made it very difficult for the insurance industry to provide any insurance coverage at all.

Let me mention, because it was brought up here, Canada. Mr. Hunter said that many of the things that we are advocating here exist in Canada and they are still having the same problem of availability of insurance and the rising cost of the insurance.

The main thing to point out was nothing has been changed with the law up there. The restrictions they have on attorney's fees—they don't permit the contingent fee up there. They cap the noneconomic losses. They don't recognize punitive damages in many cases. Those rules have existed for many years.

What is happening up there is exactly what I told you is happening here. The Minister for Consumer Affairs said the reason that the prices are soaring, first he recognized it is a worldwide problem, second, it was due to high court awards, low interest on investments and competition had cut the rates for many years.

I am sure you heard before this panel came up that the insurance industry for a 6-year period was in heavily intense competition on commercial liability insurance. It was brought about by in flow of capital from West Germany and Britain. It was brought about by the high returns that existed in 1978 and 1979 and once the competition got started, we had a good example of the classical economics with many sellers and many buyers making these decisions and with a very high rate of investment income and the companies were seeking to balance the investment income against what they were willing to reduce their premiums by.

In 1983, that all came to a halt. They began to recognize that they had gotten themselves in a very difficult situation.

If I could illustrate——

Chairman PICKLE. Mr. Jones, let me interrupt you. I have asked you a question. All the members are limited to 5 minutes. I have already gotten more than 5 minutes with that answer. Let me say that your answer is very helpful because I have asked what type of tort reforms you advocate and you have certainly been specific.

I do not want to cut you off. We will try to come back to you, and I thank you for your cooperation. Will each one of the witnesses try to respond equally as quickly as our members ask the questions.

Mr. Hunter, you said insurance prices are primarily cyclical and then you pointed out the special privileges of the insurance companies. For example, they are exempt from the antitrust laws; they are exempt from Federal regulation; they are protected by competition and State regulation; they are exempt from Federal Trade Commission jurisdiction; and there is no regulation on foreign insurance.

That indicates to me that you are advocating Federal regulation or control in some manner, I presume along the line that you recommended for the automobile industry on no-fault.

Are you advocating Federal reform or control of the insurance industry by regulation in some manner?

Mr. **Hunter**. What I proposed, attached to the statement, is that the McCarran-Ferguson Act should be sunsetted. That is the act that exempts insurers from the antitrust laws. I think this industry can be subject to the antitrust laws and so does every study that has ever been done by the Justice Department, by the President's Commission on Anti-Trust Laws and Procedures, and so on.

Second, I think there should be a Federal office to monitor the insurance industry and the States and to establish standards for State regulators if necessary, particularly on these cyclical patterns.

Some States try to control this bottom. For example, Texas. Lyndon Olson will testify later today. They did try to impose a floor to stop the price slashing, to stop the cycle and its ultimate result. As one State, he couldn't do it. One State is not enough to stop the cycle. As a result, Texas today has the adverse results of the cycle, cancellations, higher prices and the rest, even though they didn't allow the rates to go down as low as some other States had.

I suggest that there is no principaled justification for the FTC being excluded from the right to study insurance. I suggest that the Risk Retention Act should be expanded to allow groups to be formed. As a result of the last crisis, the Product Liability Risk Retention Act was expanded. I suggest there might be Federal control of Lloyds of London and other foreign reinsurers at least to the point of getting some statistics from them. They are a little bit like OPEC. They can turn off an industry in terms of the insurance that flows to it; if they decide day care centers won't get reinsurance, then the insurance will dry up.

I think we should be looking at ways to encourage a domestic reinsurance market. I did administer, as Federal Insurance Administrator, a riot reentrance program which kept insurance in the inner city areas during the riots and made $125 million for the Federal Treasury. The Federal Government could do it as an interim step.

I would encourage finding ways to develop a private reinsurance market in this country that would be at least subject to some control regarding the cyclical periods.

I don't call for Federal regulation of insurance. I think State regulation should be the primary focus. I think there should be Federal help. I think there should be a Federal office to study and to recommend to Congress—there is no reason why Congress shouldn't have good information on insurance. Twelve percent of the disposal income flows into the insurance business in this country. It is the third leading purchase, moving ahead of Federal income taxes in this last year.

I think you have to at least be aware of what is going on. I suggest there be this office that would then recommend to you the kinds of roles that would be best.

Chairman PICKLE. I thank you. I am going to make a statement and then I am going to yield to Mr. Schulze.

I think your testimony is very revealing in the sense that it gives us some facts as to what the public is thinking. When your survey showed that 20 percent of the businesses surveyed had not been able to obtain or renew liability coverage, that is rather shocking. Also, 35 percent of the people interviewed considered going bare, that is having no insurance, and premiums had increased from 100 to 500 percent, with over 10 percent having increased over 500 percent. It is shocking and frightening to hear those statistics.

I said I found that interesting although it is regretful to hear. I also found it very interesting that your organization has been holding townhall meetings throughout the land in recent weeks, simply to discuss this problem and to allow small business people to come together and complain about what is happening to them. I am glad to have your testimony

I am not going to ask you another question at this point. I want to yield to other members and ask them to stay within the 5-minute limitation. I have taken a little more than that because the answers have been longer. Let's try to stay within the time.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Thank you all for your testimony.

Mr. Hunter, you state that insurance companies are exempt from antitrust law. In your testimony you say this allows insurance companies to agree to raise their prices and executives of other industries would go to jail if they did the same thing.

Isn't it true that if the insurance executives who are in this room today went back in the library and sat there and decided to raise rates or collude on prices, that they could be prosecuted under current law?

Mr. HUNTER. No.

Mr. SCHULZE. Mr. Jones, do you agree with that?

Mr. JONES. No; I do not. In New York, they passed a separate antitrust law when they passed a separate antitrust law when they passed what they call a competitive regulatory law.

Mr. SCHULZE. Mr. Hunter, you said no. What we are trying to do is get at the facts here.

Mr. HUNTER. In most cases, I would say no.

Mr. JONES. I would disagree with that. I believe in most cases they absolutely could.

They could be prosecuted for an agreement on rates where the agreement was not approved by the State regulator. That was the requirement of the industry law that was passed between 1947 and 1949 in all States except our good State of Texas. Texas have maintained sort of a prior approval system.

Mr. SCHULZE. Thank you, Mr. Jones.

Mr. Hunter, why are life companies with P&C affiliates limited, unlike any other industry, from using consolidation? Why do you think it should be? Or do you think it should not be?

Mr. HUNTER. I do not know that it is relevant to the current issue.

Mr. SCHULZE. Well, I think it is, when you are talking about losses and you are talking about overall losses of companies versus just the P&C operations. But you do not think consolidation is important one way or another?

Mr. HUNTER. Not in terms of this issue, because these companies are walled off from the point of view—and are part of the cyclical pattern.

Mr. SCHULZE. Mr. Jones, do you think that consolidation is important?

Mr. JONES. Is important? Yes, it is important to the industry. It comes—the limit comes from the traditions of the insurance industry sometimes described cigarbox accounting where we had separate companies for life companies and separate for property and casualty and to properly regulate them they did not want them consolidated.

But consolidation makes a stronger merged company.

Mr. SCHULZE. For purposes of this fairly narrow issue, what I am saying is should we take into account the profits from other consolidated companies or should we just look at P&C?

Mr. JONES. We should look at P&C. We should not——

Mr. HUNTER. I agree with that.

Mr. SCHULZE. You both agree with it, OK.

Mr. Joseph, to what extent are these high costs of P&C making us less competitive in world markets?

Mr. JOSEPH. I do not think at least a week goes by that I have not seen one business publication, or another, citing the latest casualty of the week. There is something I saw in Forbes just the other day, talking about the reverse of that.

Now when I talk about the first part, most notably a recent Fortune Magazine cover was about the decision of G.D. Serle to pull the Copper-7, the IUD that Planned Parenthood recommended as the best and the safest, off the market. They did that because of—not because they have an unsafe product, but it was costing them $1 million to win every case and they only made $11 million a year on the product. And they had one lawyer with three additional cases pending against them that they had already beaten once, at the cost of $1 million.

So you see what happens. That is just one visible example. And the sporting goods people I met with this morning, they are shifting their operations overseas. They are not going to sell certain athletic equipment here because of the kinds of suits they are exposed to.

But the article I saw in Forbes the other day talked about how—and to some extend the rug got pulled—let me jump back a second.

To some extent, the rug got pulled out of the property and casualty market here when Lloyd's of London had some problem of its own and, because the English market is the greatest proportion of our reinsurance, looked at us and they looked at all the other places they do business in the world, and they see the American legal system is one that they do not know how to price, because the awards get higher.

Mr. SCHULZE. Does the foreign competition suffer under the same problem? In other words, are their rates increasing proportionately?

Mr. JOSEPH. Yes, that is what the most recent article I saw said, that some British manufacturers now do not want to export their products to America, because they do not want to get caught in the web of the same suits. And so you may, theoretically, get to the point where products the people want are not even available.

Mr. SCHULZE. How about their rates? How about the rates in Japan and——

Mr. JOSEPH. No, it is a different situation there. I met with representatives of a multi-national corporation yesterday, that told me that they have been able to buy all their other insurance elsewhere in the world, at reasonable rates. But for their American subsidiaries, they are high and dry and they cannot price it anywhere in the world.

Mr. SCHULZE. Thank you.

Mr. Jones, if the Risk Retention Act of 1981 were expanded, how could the insurance industry participate in managing risk, pools, or offering reinsurance?

Mr. JONES. A number of our companies do have those services that they make available to risk retention groups. And certainly, as you see in our statement, we would not oppose in any way the extension——

Mr. SCHULZE. Mr. Hunter recommended this, too. Is this an area that we could find some mutual ground and have some agreement on?

Mr. JONES. Yes, we just urge that you find that there really is a need for risk retention in the new areas, and that there is some proper regulation, so that there are not unpaid losses ended up when a risk retention group is unable to respond.

Mr. SCHULZE. Thank you, gentlemen.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Jones, just flipping through the testimony of Mr. Habush, he says that the assets of property and casualty companies have grown steadily during the last 30 years, from $22 billion in 1955 to $265 billion in 1984. Then he talks about cash-in and cash-out with a chart showing that there is more cash coming in than there is cash going out.

He talks about the following statement, "Is it not interesting that the reserve line dropped sharply, from 1979 through 1982, with all of this claimed explosion in settlements and jury verdicts in a society awash in litigants."

He has some good points to make. It appears that it is not the tort system that—or the civil justice system that is hurting you. Is it some pricing policies of the industry itself?

Mr. JONES. As I explained, part of it is the pricing policy. It is true that the assets or the net worth of the industry has grown every year except in 1984. It dropped $2 billion in 1984, but it has recovered that in 1985. And that the reserves have grown because there are tremendous—in the liability line they are what we call long tail claims. In other words, there is a long period of time between the current income and the actual payment of an award. And that situation has gone on, particularly in medical malpractice, for a great number of years.

And so the reserves did grow.

The last point, I am not sure I understood.

Mr. ANTHONY. He was basically talking about the reserves being adequate and the surplus allowing you to write more insurance. I guess an underlying statement. What many of my constituents ask, is why should the current policy holders in 1986 have to pay for the industry's decision in the the 1970's to engage in pricing cutting in order to expand the amount of premium income available so that you could gamble in the stock market and gamble in other endeavors?

Mr. JONES. I do not believe they are paying for those past decisions. All the companies are trying to do is get premimums up where, on their insurance operations—from their regular investment income and their regular premium income—that they are making a net operating gain. We have had two tremendous net operating losses in 1984 and 1985.

Mr. ANTHONY. I guess what disturbs me, as a businessman, if you went back 7 years ago, you would see that your premium income was here and your losses were here and your investment income was here and you had a huge surplus because you had more investment income.

Seven consecutive years that has occurred, yet you continually price cut on premiums. And I could understand you could do that for 1 or 2 or 3 years, but the 5th, the 6th, and the 7th year, it just appears to me that the industry itself has said we do not give a damn. We are going to price cut to get income. We are going to get as much business as we possibly can get because we know we are going to offset it by the investment income.

I wish you could explain that to me.

Mr. JONES. The industry itself is very puzzled about the length of this cycle because, as you indicated, these cycles usually went in 3 year periods of going up and 3 years of coming down. But here it is explained by an influx of capital from West Germany and from Britain and also from domestic sources in the United States, that were not previously in the insurance industry, coming in and competing strenguously.

And a company faced with the fact that it could lose a large account, wondered if it could adjust, could it lower its overhead, could it fire enough people in a short period of time? And companies made decision after decision that they were better off with a lower premium than they were with a total loss of premium of a major account.

And it got very intense. They were very unhappy about it. Every industry meeting they urged that they get back to realistic pricing. But it reached a point in 1983 that they finally recognized that they had to reverse that cycle. The last 4 or 5 years of the cycle were very, very difficult for them.

Mr. ANTHONY. What you are saying is that Ben Pearson in Pine Bluff, AR, who has had 30 years of real good experience gets no credit or no break in 1986. He has got to pay a sixfold increase in his premium, along with everybody else, in order to make up for the industry's excesses?

Mr. JONES. He got his insurance below cost, very cheaply, for 6 years and there is just an adjustment taking place. We have here the classical competitive economic system.

Mr. ANTHONY. I understand that. But could not that small businessman better have absorbed that rate increase a sixth for 6 straight years, rather than dumping it all on him in 1 year? I mean, how come you do not raise your prices gradually, over the next 5 years, rather than dumping it on small business America overnight?

Mr. JONES. Well, I think they are spreading it out, at least over more than 1 year to catch up.

From his perspective, I presume he would like a more gradual increase, but I also imagine he was pleased when his insurance did not go up over that period of time.

Mr. ANTHONY. No one is going to gripe about low cost, but if you have an industry practice that you know is going to come to a screeching halt someday—you know, that is the reason we are here, to discover all of that and see if there are any reasons.

I thank you. I see my time has expired.

Mr. GUARINI. Thank you.

Mr. Thomas.

Mr. THOMAS. Mr. Habush, in your conclusion on page 13, "The so-called crisis orchestrated"—et cetera—"is intended to force legislators into curtailing the rights of consumers to recover damages when they become the victims of wrongful, negligent, and culpable conduct of others." Do you believe that the definition of what is wrongful, negligent, and culpable behavior has changed over time, say since World War II or since the 1930's or since the 1920's?

Mr. HABUSH. Yes.

Mr. THOMAS. And in what way has it changed?

Mr. HABUSH. I think that in one respect, strict liability has become adopted in most of the States in this country. That permits recovery for unreasonably dangerous and defective products against foreign manufacturers who can't be touched by people in this country but can only be touched through retailers or wholesalers.

Mr. THOMAS. Would you say that what people feel as a reasonable risk or responsibility on the part of individuals has shifted in a societal nature rather than a narrow governmental legal way?

Mr. HABUSH. I think that without question, Congressman, the basis, the philosophy of the tort system is to let the victim recover, to permit the innocent victim to recover his or her damages, and a philosphy that the people who are most able to pay for these acts of negligent conduct should do so. There is a shifting of financial burden from the innocent victim to the people who can most afford to pay for it, as opposed to the public or the taxpayer.

Mr. THOMAS. And if that shift is occurring and it tends to be somewhat societal wide and over time, don't you think, then, that it is somewhat reasonable that where you have repeated examples of similar risk or similar liability, that there ought to be more of a structured response in terms of awards and settlements rather than leaving it up to juries to determine on their own?

Mr. HABUSH. Obviously, Congressman, being a trial lawyer, I have a passionate love for the jury system, as do the United States and State constitutions, and the people who are cynical and disrespectful of the American jury are of course the very people who are told by American juries that they have been acting irresponsibility.

But most sociologists will tell you, Congressman, that the greatest deterrent to reckless, negligent, and irresponsible corporate arrogance has been the American jury; that Government regulation has failed miserably in that respect and there are countless stories of manufacturers being held accountable by juries for outrageous conduct.

Mr. THOMAS. So you feel there is just a choice between two positions, one an absolute pure one, which is the one that you represent, and the other one, which tends to be corruptive and perhaps basically unconstitutional. I just have a little difficulty with the entire black and white nature of the way in which you present the argument.

Mr. HABUSH. Oh, I don't suggest it is black and white, sir.

Mr. THOMAS. Well, maybe we better review the way in which you have outlined the choices that people have to make.

Mr. HABUSH. Let me put it this way. I deal in evidence, as you should. You are like a jury, and you should listen to evidence. If there is evidence presented to you which indicates to you that the jury system is responsible for this insurance crisis, then consider doing something about it; but I reject that completely. I think that is totally false, and I don't think you are going to hear any evidence that the American jury is responsible for it.

Mr. THOMAS. The way it works is you make your pitch and others make their pitch. I just think you also ought to realize that the more realistic your pitch is, the better chance that people have of believing your argument.

Mr. Joseph, do you want to make a comment?

Mr. JOSEPH. If I could just add, trial attorneys, trial lawyers are on both sides of the case. The defense bar represents in the aggregate about 17,000 lawyers who defend people. They have a number of organizations, the largest of which is the Defense Research Institute in Chicago, but in the aggregate they have banded together for the last 2 years in something called the National Coalition for Litigation Cost Containment, and there are 17,000 trial lawyers on the other side of Mr. Habush who believe that there are a number of reforms needed in the legal system.

Mr. THOMAS. Let me ask you directly, are there any possible tort reforms that you would consider accepting or is the system absolutely perfect the way it is?

Mr. **Habush**. No, the system is not perfect, sir.

Mr. **Thomas**. Could you give me a couple of specific suggestions that you believe ought to be done to reform the tort system?

Mr. **Habush**. First of all, Congressman, I believe that in terms of reforming the tort system, which by implication refers to some of the measures proposed by the insurance industry, I——

Mr. **Thomas**. No, I'm giving you a complete blank sheet of paper. You said that it wasn't perfect, that you would like to suggest some changes. What are they?

Mr. **Habush**. I think that there should be some consideration of the smaller claims which at the present time are not handled by the system, claims which fall between the cracks because they are so expensive to prosecute. I think there are lots of small products liability cases, defective products cases that are not handled by the tort system.

I think that——

Mr. **Thomas**. So the answer is more of the same except open it up for more people. That is your reform, the suggestion that you make.

One last question. On page 14 of your testimony you say that States should encourage the Federal Government to be more active in regulating the insurance business. Does that mean you advocate Federal involvement in terms of regulation of the insurance industry?

Mr. **Habush**. Yes, sir.

Mr. **Thomas**. In what form?

Mr. **Habush**. I think there should be repeal of the McCarran Ferguson Act, I think there should be investigation by the Federal Trade Commission. I think the State insurance commissioners have totally abdicated their control and regulatory responsibility over insurance companies, and, witness what is happening today, that they have lost control over ratemaking by insurance companies in their States.

I think the Federal Government is the only authority that can bring the insurance industry back under control.

Mr. **Thomas**. At least you are consistent in your arguments.

Thank you, Mr. Chairman.

Chairman **Pickle**. Thank you.

Mr. Dorgan.

Mr. **Dorgan**. Thank you, Mr. Chairman.

This is an interesting discussion because I think, Mr. Habush, that you have given us some information that is useful in evaluating the response from the insurance industry, and I think Mr. Jones, Mr. Hunter, Mr. Joseph, and you have given us some information that allows us to evaluate whether tort reform might be necessary.

Mr. Habush, I guess I feel there are plenty of lawyers who tell me from time to time that the system is haywire. I recall the airplanes going to Bhopal after the accident there with all the lawyers going in the public spirit to try and help all of those victims and sign them up as clients. It probably represents, in a more visible sense, what is going on all across this country.

Mr. **Habush**. I disagree, Congressman. I think that the conduct of attorneys or insurance companies that go to the scene of a mass disaster, uninvited, is reprehensible and should be condemned, and I don't think it represents the conduct of the mainstream of plaintiff trail lawyers in this country but rather a fringe, and a lunatic fringe, I might add.

Mr. **Dorgan**. Were you embarrassed by that as well?

Mr. **Habush**. You damn right I was.

Mr. **Dorgan**. Thank you.

I guess the point I am trying to make, however, is that there are plenty of Wyatt Earps with legal books swaggering down main streets all across this country who are willing to look for a quick hit or a big score. I have got lawyer friends who tell me that the system has gone haywire.

I'm not suggesting that the plaintiff bar is totally to blame, although I think we need some tort reform. I believe that very strongly. But I think the system, at least in some quarters, and I don't mean to use the exception to demonstrate a rule, is probably stimulated more by greed than good sense. I think we ought to recognize that and we ought to do something about it.

Let me say that I come from a small community of only several hundred people. We have small communities in my State which find that they are not able to get appropriate insurance at a reasonable price. They are in some cases having to close down their swimming pools. I have a friend who has a main street business who wrote to me and said that his liability insurance went from $5,000 to $20,000-plus.

We are trying to discover what is causing all of that and what should we do about it.

Mr. Habush, you have provided some information, and I am not satisfied, frankly, with the response, from the insurance industry to this information. I think the information is very constructive. In an area where there is not much data, you give us information about surplus assets and liabilities of the insurance industry from 1967 to 1984. Mr. Jones responded in part to Mr. Anthony on that, but I am not very satisfied with the answers I am getting.

I don't understand what is happening out there. Half of the biggest property and casualty companies are being bought by other large insurance companies which demonstrate big losses and file consolidated returns. I don't understand all that. Can you amplify for me?

Mr. **Jones**. I'm not sure what you are directing the question to.

Mr. **Dorgan**. Mr. Habush has provided some very revealing information about the industry, and I have heard your response to it, but I don't understand the response. He is demonstrating increasing surpluses, increasing assets, not decreasing liabilities.

Mr. **Jones**. During this 6- or 7-year period we were talking about, we were balancing the increased investment income and taking it into consideration in determining the premiums, and it ended up with premimums written at less than the loss cost and expenses—at what is called an underwriting loss. The reason that that was done is because following the crisis of 1975 and 1976, a number of companies went into self-insurance. They had high risk retention because they were seeking to get the investment themselves, so there was a necessary adjustment that needed to be taken into account.

In 1984 there was a substantial operating loss of approximately $4 billion, and although the industry premiums went up in 1985, we are going to have approximately over $5 billion in an operating loss. An operating result is determined after considering regular investment income.

Now, that causes us to readjust the premiums to take into consideration the real loss cost that is coming through the system, and also to adjust to the rate of the investment income that is coming in through the system so that our operating result is at a realistic level.

Even considering all nonoperating factors and adjustments the industry's fund results was under 2 percent on net worth in 1984, and final results will be no better in 1985, and that kind of financial result is not enough to sustain the capital in our industry unless we continue to make adjustments on return on net worth.

Mr. **Dorgan**. I think we have got a lot of work to do to verify the information and the data. Mr. Hunter, did you have a comment?

Mr. **Hunter**. Yes, I just wanted to make a comment. These losses, these underwriting losses that the insurance industry puts forth are based upon what is called statutory accounting, something you are going to have to look into. It is a worst case scenario. The question that is being asked of the insurance companies in statutory accounting is this: As of midnight on December 31 of this year, if everybody cancelled their policy and you had to pay every claim, even if it isn't really going to be paid for 10 years, then how would you look?

That is the question. So they don't discount reserves, and GAO has pointed that out in a tax situation, but is also true in accounting. They don't discount the reserves. There are other adjustments that should be made. And when you do that, you see quite a different picture. And that is why Wall Street shows such a remarkable pattern.

Mr. **Dorgan**. Just one question, Mr. Habush.

Are there more medical malpractice cases being filed today than 10 years ago or 20 years ago?

Mr. **Habush**. Yes.

Mr. **Dorgan**. Is there more medical malpractice or just more attorneys interested in practicing in that area?

Mr. **Habush**. Both. And there is definitely more medical malpractice. I think the studies which have been done, which we will submit to the committee, indicate that doctor discipline is woeful and lacking, that from 20,000 to 40,000 doctors are impaired by physical, mental, drug or alcohol abuse or incompetence, and that the medical profession has not responded to this at all.

Congressman, let me tell you, that in my State like in most States, insurance companies rate doctors in tiny little pools, so that in my State, 49 neurosurgeons are rated in a single pool, and those 49 are adversely affected, obviously, by one or two incompetent doctors who are practicing medicine in the State. There needs to be a close examination of the medical malpractice insurance situation because if companies were to collapse the categories and experience rate the doctors, the situation would be alleviated remarkably.

If I were to tell you that a doctor who has never been sued pays the same for his malpractice insurance as a doctor who may have had 12 successful malpractice judgments against him, I think you would be astounded, but that happens to be the fact.

Chairman PICKLE. The time of the gentleman has expired.

Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman.

Mr. Jones, the chairman asked you for information that may or may not be provided by the ISO. In preparation for this hearing, I think I read something from the ISO that recommended over the last maybe 5 or 6 years or so, based on claims, a gradual increase in premiums, but in actuality, the premiums charged by companies were on a downward declining spiral.

Given that statistical information that you supposedly should take into account to make those judgments, what prompts most insurance companies to decrease premiums when the statistics indicate that you should be increasing premiums?

Mr. JONES. The competitive forces in the market to maintain the premium volume that you have, which supports all your overhead, all your employees, all your operations.

Mr. MCGRATH. Do you mean to tell me that the increase in the volume of sales more than compensates for the loss in premium income?

Mr. JONES. I'm not sure I got that question, but the underwriting loss was more than compensated by the extraordinary investment income that occurred in the latter part of the seventies and the early——

Mr. MCGRATH. Mr. Hunter.

Mr. HUNTER. Mr. McGrath, I'm an actuary, and one of the reasons, I think, is that the ISO does not fully factor investment income into its rate-setting calculations. So that is one of the reasons, probably, a company would go in and go a little further down than the ISO indication.

Mr. JONES. That is correct, if that is what you were driving at. The ISO does not entirely factor that in. The individual companies have to do that. The individual companies have different investment philosophies, different projections of what they will get on investment, and they have to take that into consideration as to what is necessary to maintain their position in the market.

Mr. MCGRATH. On another subject, we all recognize that the States regulate insurance companies. Let me ask you this. Do you feel that the State insurance departments are in business to regulate the solvency of insurance companies or the regulation of the premium costs to the consumer? And if so, how does it affect the business?

Mr. JONES. There is probably a tension there. We are constantly urging them to regulate for solvency, and we tend to feel sometimes that they are regulating for the price to the consumer, but I think there really is a balance over all.

Mr. MCGRATH. How does the consumer feel about that?

Mr. HUNTER. Obviously, the consumer wants an insurance company around when the loss occurs. We feel that the key problem in solvency is the woefully inadequate insolvency fund mechanism in the States. If you had a real serious insolvency, it would make the Maryland S&L crisis look like a tea party in this country. So we think that is where the strengthening should be because if we are going to rely on competition to establish rates, you have got to expect some companies sometime to go under. Inefficient or mismanaged companies will go under.

We think the way to control that is the insolvency fund mechanism, which we think should be studied. What would have happened if Baldwin United, for example, would have had to go through the insolvency fund mechanism? The insurance executive that runs the State of Indiana's insolvency fund said it would take 40 years for Indiana to pay off the principal through the insolvency fund, much less the interest.

So there is serious problem there.

Mr. McGRATH. Is there any reform that could be entertained that would solve the current problems and also facilitate fair judgments for plaintiffs?

I'm wondering how you would answer that, Mr. Hunter?

Mr. HUNTER. Yes. Attached to my statement, I have a list of not only insurance reforms which I think really would control the current cycle and current crisis, but some tort reforms that we think would make the legal system more efficient, including limitations on lawyers' fees, both defense and plaintiff; sanctions for frivolous suits, frivolous defenses; prohibitions on secrecy agreements, so that you don't have to prove the same case over and over again and run your clock; transferring small cases into other than tort systems, such as no-fault regimes, increasing the use of voluntary arbitration and so on.

Where we draw the line and say no is, don't take away the rights of victims until at least you have the analysis from the closed claims that would indicate what the problem is and what the reform would do in terms of saving money, if any, making insurance more available, and what would the victim's outcome look like in the future. I think that's very important before we start to go in after the individual, because those data are in the files of insurance companies. You have to ask this question, since they're proposing such massive "reform"—where's the data?

It's in their files. They must have studied it. I can't believe they'd be so naive as to not look at the data that they have in their own files. Where is it? Why haven't they produced it?

Mr. McGRATH. My time is rapidly evaporating. On risk retention—the pooling of risks by certain industries—it is my understanding that in New York where this was attempted among the medical profession, that they rapidly found out that the losses of these pooled entities were the same as the insurance companies. What is the experience elsewhere with risk retention?

Mr. HUNTER. Well, there's no question that the fundamental loss would be the same. Obviously if you're self-insuring through a group, you don't have to pay a profit, and you may find more efficient ways to deliver the services, and you keep the investment income all for yourself. So it should in the long run be a cheaper operation. But that doesn't mean you'll have lower losses, unless you engage in some kind of good risk prevention.

By the way, that's an area that the committee should look at, Mr. Chairman and members of the committee, risk prevention, because obviously if we put caps on awards and things like that, all we're doing is shifting economic burdens. But if we can eliminate an accident, that's the best solution for everybody.

Mr. McGRATH. I thank the chairman for his indulgence.

Chairman PICKLE. Thank you, Mr. McGrath. Mr. Flippo.

Mr. FLIPPO. Thank you, Mr. Chairman.

Mr. Habush, in your testimony on page 3, you point out the very large increases from $22 billion in 1955 to $264 billion in 1984 of property and casualty company assets. You also point out this cash-in/cash-out area, and indicate that insurance companies do not need increased premiums.

I think the increases in assets was also pointed out by Mr. Hunter, very large increases in assets and stock market gains.

Mr. Jones seems to be saying that these losses are tremendous problems. You seem to think that's not much of a problem.

How do you reconcile these two areas, Mr. Habush? Mr. Jones seems to say that the losses are the prime driver, and you seem to say they don't need it. How do you reconcile it?

Mr. HABUSH. Well, here's how I reconcile it. I think it was touched on earlier by another Congressman.

Insurance companies are in business to write risks and to pay claims. Eliminate claims, you can eliminate the insurance companies. What insurance companies are required to do is act responsibly. And as indicated earlier, I believe that had they acted responsibly in the late 1970's and early 1980's we wouldn't be here today, because nobody would have been kicked out of the market or receiving 1,000-percent increases.

So I think that insurance companies have a right to raise premiums consistent with inflation, but they have a duty to do it in a responsible way and not to go and price products below cost, and then to try to make up for it in 1 year, and that's really what they've done.

Mr. FLIPPO. I think what we're really trying to get at is, what are the relevant costs? You suggest that perhaps insurance companies should be required to report on a line-by-line basis on loss data. What would you expect we would find if they did that?

Are you telling us that the industry now charges higher than necessary premiums to one insured group in order to cover losses in another group that's at greater risk?

Mr. HABUSH. Absolutely. I think if you people were to get line-by-line information, and if you people were to subpoena and obtain closed claims information, which no congressional committee to my knowledge has ever been able to get from the insurance companies, you would see the answers to these questions in very real detail, and I think that you would find, as Mr. Hunter has said, that the net overall profit after taxes for insurance companies has been consistently good, although in the last couple of years, due to their own stupidity, less than they'd like it to be.

Mr. FLIPPO. Let's let Mr. Jones respond to that as well.

Mr. JONES. No, sir. Competition would not let you transfer losses from one line of business to another line of business. Each line is approached in its own way, in its own competitive market.

Mr. FLIPPO. Mr. Jones, could you give us some kind of information on the relative importance of, say, homeowners and autos to other kinds? What is the relative volume or profitability of those in the mix?

Mr. **Jones**. Now the personal lines, homeowners and private automobile, have had good results all during this period, and their increases have been rather modest and along a steady line. There is more increased competition in the personal lines right now, because they prove to be the most stable and the largest—the most stable and with the best return through this period of time, and so they are much more attractive to the companies that have been the commercial lines.

Roughly 50 percent of the business is in the personal lines, and 50 percent is in the commercial. But the companies don't have that same sort of balance. The companies that I represent probably have 20 percent personal lines generally and 80 percent commercial. We're the primarily commercial——

Mr. **Flippo**. Mr. Hunter, do you have a reaction to this?

Mr. **Hunter**. Yes. I think what Mr. Jones says is about right. It's about 50–50, and the profitability was better in personal lines. There were even some points in the cycle where it looked to me that they were underpricing commercial and using some of the profit from the personal lines to fund it, because, don't forget, the personal lines don't have the choice to self-insure like the large commercial accounts. So if you're trying to retain market share from those large accounts, and they have the option to go offshore or self-insure, sometimes you may have to even go below cost, which is what they did at some points on the cycle.

Mr. **Flippo**. Mr. Chairman, out of respect for the Chair, I'll yield back the balance of my time. Notice, I didn't use all of my time, Mr. Chairman.

Chairman **Pickle**. I notice you barely did not use all your time. [Laughter.]

The Chair now recognizes Mr. Anthony, who I believe has additional questions.

Mr. **Anthony**. Thank you, Mr. Chairman.

Mr. Jones, if you totally disagree with Mr. Habush's analysis that you are not cost-shifting over to homeowners and automobiles, would you be willing to provide this committee with some data to back that statement up?

Mr. **Jones**. Yes. Let me say in response particularly to Mr. Dorgan bringing it up, our association does not accumulate this information. It's done at the Insurance Services Office. We consider——

Mr. **Anthony**. Do they have that information?

Mr. **Jones**. Yes, they will have——

Mr. **Anthony**. Will they make it available to us?

Mr. **Jones**. Yes.

Mr. **Anthony**. Would you get them to do that?

Mr. **Jones**. We considered attaching that and bringing it in. It was only when we contacted them and they had the understanding that they were going to come before the committee, that we did not bring that information. But we will make it available.

Mr. **Anthony**. Just a quick yes or no answer to the following question: Charlie Van Ness, a longtime personal friend of mine, operates an insurance agency. He's been representing Hartford Insurance Co. in this particular agency for over 50 years. They have just recently written him a letter and canceled.

Is this something that is going through the insurance industry in a wanton way, just after 50 years of agency relationships, canceling of those contracts?

Mr. JONES. No, it's not a wanton thing, and it's not across the board.

Mr. ANTHONY. So that's just a company and agency relationship.

Mr. JONES. It just happens to be an individual situation.

Mr. ANTHONY. So that's just their personal fight.

Mr. JONES. I couldn't respond in that case.

Mr. ANTHONY. But you don't think it's an industrywide problem?

Mr. JONES. No, I'm not seeing that.

Mr. ANTHONY. Mr. Hunter, you look like you want to jump in.

Mr. HUNTER. I was going to suggest, sir, that you should ask that question, I think, of the agents' associations, which could probably give you some fairly good advice on that.

Mr. ANTHONY. We'll ask them about that.

Mr. Joseph, on page 2 of your testimony, there is something that is very, very disturbing to me. If you'll look on the bottom part after you've talked about other parts of your survey, it says that "90 percent said that the civil justice system encourages frivolous claims," and the next one is just absolutely staggering to me. It says, "84 percent believe that liability is based on the ability to pay and not on wrongdoing."

The chamber of commerce certainly does not ascribe to that, do they?

Mr. JOSEPH. I can't answer that the way you want me to. I can tell you——

Mr. ANTHONY. Well, let me ask you personally, do you ascribe to that statement, that liability is based on the ability to pay and not on wrongdoing?

Mr. JOSEPH. In some instances, yes.

Mr. ANTHONY. Do you think the courts are awarding moneys to noninjured and nondamaged and nonresponsible parties simply because they feel they have the ability to pay?

Mr. JOSEPH. The reverse. I believe there are instances where people who have been injured are collecting their compensation from someone who was not at all involved, in some instances, or maybe 1 percent involved, but is responsible, and five other parties collectively are 99 percent involved. But the one with so-called deep pockets gets 100 percent of the bill. That, we know, happens day-in an day-out.

Mr. ANTHONY. All right. So under your tort reform, then you would say to that injured person, "You should just remain injured, and society owes you no ability to collect that money?"

Mr. JOSEPH. No. The first thing you have to——

Mr. ANTHONY. Then you're saying to that person who's 1 percent negligent, that causes 1 percent, that they walk away free?

Mr. JOSEPH. One of the reasons there has been great impetus to find the so-called deep pockets is because of the enormous size of these awards. I can show you clippings upon clippings of people who have absolutely no ability to pay, who are held liable for some tragedy, but then a dollar amount is attached to that that no, quote, "reasonable" one person, but yet maybe a jury of 6 or 12 came up with as a number that someone should pay, and they look through the chain of events and——

Mr. **Anthony**. Under joint and several liability.

Mr. **Joseph**. Yes. And so you come up with someone with a big tab.

Mr. **Anthony**. Well, is there anything under civil jurisprudence of 1986 that changes joint and several liability? I mean it is a doctrine—I graduated from law school in 1963. I studied about it 20 years ago. So what has occurred over that period of time that makes it now so onerous?

Mr. **Jones**. The courts have—you know, when it was developed, there was a real joint relationship between the people, and the courts have expanded it where there is not a truly joint activity.

Mr. **Anthony**. OK. Let's make an assumption now that you have won your argument, and joint and several liability has been reformed. The one person that is 1 percent negligent has the deep pocket; the other people who are 99 percent negligent have a shallow pocket. They're sued, judgment, judgment not collectable.

Now, then, your industry is not subject to this massive amount of lawsuits. Mr. Habush's army can't come after you in the court because his wings have been clipped, either by Federal law or by State law.

Now somebody's premiums are going to be lowered? Whose premiums are going to be lowered? What lines of insurance are going to benefit by that type of tort reform? What businessman can I go back to in Arkansas and say that if I vote for this, you're going to lower their insurance premiums.

Mr. **Jones**. It would be in the commercial lines, particularly the environmental pollution and in those liability lines.

I want to go back and support his statement in there that there is a trend toward making awards not based on fault, but based on need, that the victim is viewed as having need. I can even cite a case in New York where we went over—the court had a committee that worked on clearing up the docket, and they were going over the cases, why they hadn't been settled. The judge asked why this hadn't been settled, and our representative said, "Well, there's no fault there," and everybody immediately broke out in laughter.

That was the reason that our companies went to the support of a no-fault automobile system, is because they were no longer looking at fault. They were looking at need, and they were making awards.

Mr. **Habush**. Mr. Congressman, I'm not going to swap anecdotes with this person. His stories and the stories of people getting all these awards with no proof of negligence is an insult to the juries and to the judges and the appellate courts who would do something about that.

We will submit to you studies by the Rand Corp. and other groups that have actually studied verdicts and studied results, and you won't have to listen to anecdotes most of which never occurred.

Mr. **Anthony**. Well, Mr. Habush, the Congress is not going to legislate on anecdotes.

But, Mr. Chairman, if you'll just bear with me, I am totally not satisfied with the answer that I got to my question.

Mr. Joseph, you represent the U.S. Chamber of Commerce, and Mr. Jones, you are representing the insurance industry. I would like to submit this question to you and have you think about and respond back in writing.

I wish you could tell us exactly which tort reform measures will result in a lowering of premium rates, by what amount, for whom, and in expanding coverage to what specific groups? In other words, if you're going to come to the Congress or to the State legislatures and ask for tort reform, there has to be something that is obtained or given in return for that, other than that money going into your bottom line to pay out in profits, dividends, et cetera.

[The following was subsequently received:]

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

JEFFREY H. JOSEPH
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June 27, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of June 6 requesting follow-up information to my testimony of March 13, 1986. I appreciate your allowing me the opportunity to clarify and expand my remarks.

Specifically, I wish to respond to Representative Anthony's question. We believe that each of the tort reform measures listed on page 7 of my testimony will contribute to stabilizing the liability insurance market, and eventually will lead to lower liability insurance costs. Overall, the lack of consistency in result (in holding defendants liable) means that the tort system is less amenable to actuarial development of risk of loss. The unpredictability in award amounts makes it more difficult to predict risk than in a system where benefits can be quantified objectively.

Lack of predictability in the system is exacerbated by expansion of tort liability and recovery theories. Also, traditional tort rules concerning proof of fault, identity of the defendant, and proof of causation have been stretched or broken by the courts. The result is an unpredictable system, where plaintiffs remain entitled to receive compensation without limitation and without having to meet appropriate burdens of proof. In such a system, where plaintiffs receive enormous sums based on ambiguous legal doctrines, insurers naturally are unwilling to offer coverage for activities for which they cannot predict the risk.

The tort reform measures which we seek would clarify standards of liability and reduce transaction costs inherent in litigation. Insurers then would be able to determine more accurately risks of their clients. However, it is impossible to quantify the exact positive effect tort reforms would have on insurance rates, since these rates are also the result of many other variables unrelated to the tort system.

A preliminary survey of the U.S. Chamber's membership indicates that the liability crisis has affected virtually every industry in every geographical area of the United States. Thus, we believe that significant tort reform would benefit greatly all sectors of the economy.

Again, thank you for allowing me the opportunity to express the U.S. Chamber's position on this very important issue.

Sincerely,

Jeffrey H. Joseph

If you can just assist us in that, I would appreciate it.

Chairman PICKLE. The Chair will ask that you submit that information for us.

Let me say to you that Mr. Guarini has now returned from the floor. We've got a vote and we must go to the floor, and I'm going to ask Mr. Guarini to complete this panel, and then continue with the second panel.

I want to thank you. You have given us some diverse opinions here. Mr. Jones and Mr. Joseph seem to think we ought to have an immediate reformation of our judicial system or tort system. Mr. Habush and Mr. Hunter point the finger at the insurance companies. But you all do agree that we have got a national crisis on our hands and we have got to do something about it.

Now I am going to conclude by simply making this observation to you, Mr. Jones, since you have come from our home city. I receive a lot of calls and a lot of letters from people in Austin who can't afford to obtain liability insurance. Now what is the insurance industry's responsibility for dealing with this crisis? Who do I tell them in Austin they should contact in the insurance industry to get some relief? Is there an association? Is there an organization? Do they look to the State agency, to the Federal Government? To whom would they look for relief, rather than just saying this is a serious problem? I don't have that answer.

Mr. JONES. Well, there is a State agency, a State board of insurance, and the chairman of that board will be here before you later, and let me just say that——

Chairman PICKLE. That's your answer, then, that we should look to the State and that's——

Mr. JONES. Well, you are asking what those individuals should do. They also should make a wider search, because the market is not perfect. Not every agent has contact with every part of the industry. We are cooperating with States where they feel it is needed to create market assistance programs, where they can go to the market assistance program, if the commissioner decides that he has a situation in his State that requires that. The three national trade associations do cooperate in setting up a market assistance plan that will help those agents and brokers find the market that exists.

And part of this is going to be cured by the influx of capital that is coming in and will come in to the industry as the rates become more adequate, and that part will be cured.

But it will be at a much higher cost, and that is because of the awards that are in the courts and what is taking place in increasing the cost of insurance.

Chairman PICKLE. I think, Mr. Jones, among other answers I'll give my constituents, I'll give your telephone number. [Laughter.]

Mr. JONES. All right.

Mr. GUARINI [presiding]. Mr. Jones, a lot of blame was passed around to the tort system. I want to ask you whether or not the insurance industry in your opinion should share part of this blame.

We have had sudden, high, unstable rates that have been thrust upon the public and industry. They are almost unconscionably high. I wonder whether or not you could give us some recommendations for reform within your own industry.

I assume that you want the Federal Government to set criteria for malpractice and for products liability; is that correct?

Mr. JONES. Well, for products liability——

Mr. GUARINI. If you do, do you want the Federal Government to participate in setting regulation, taking it away from the regulatory powers of the 50 States, since insurance does cross State lines in interstate commerce?

Mr. JONES. We don't think that is necessary.

Mr. GUARINI. Why? Because you have more success on the State level where you can use your influence in lobbying the State legislature?

Mr. JONES. This association of mine came to the Congress and urged for 5 years Federal standards for State workers compensation laws, and this activated the States to pass many of those standards, and finally after 5 years we withdrew our support and received the lash of Senator Jacob Javits, whose bill it was.

We also came to this Congress for Federal standards for no-fault automobile insurance programs. That was a result of the fact that we were no longer getting those at the State level.

Mr. GUARINI. Well, then, why not have national criteria for rates? Do you believe that a doctor should have 12 malpractice cases and pay the same premium, as was indicated earlier, as a doctor that has no malpractice cases? Is that fair?

Mr. JONES. Well, with 12 cases, we need a doctor's discipline system.

Mr. GUARINI. But that's not answering the question. We are relating to insurance now, not the medical association's disciplinary system.

Do you think it is fair and just that where one doctor has a whole plethora of malpractice cases, that he should pay no more malpractice insurance than a person who doesn't have a single case in his practice?

Mr. JONES. No; I would agree with you that that's not fair.

Mr. GUARINI. Well, should that be a reform within your industry?

Mr. JONES. I'm not sure he's still getting coverage. If he is through a——

Mr. GUARINI. You know, you're avoiding the questions, Mr. Jones. Is that fair in your industry? A simple yes or no question.

Mr. JONES. No, it's not fair. Your specific instance is not fair.

Mr. GUARINI. All right. So let me ask you, what other recommendations can you make? Do you think it is fair in your system that in past years where interest rates were high, that your industry should go out and write junk insurance in order to help their portfolio and compete with each other, and press the rates down, because they were getting 18 percent or 20 percent interest on their money, and then come before the public and ask for an inordinate increase in 1 year?

Mr. JONES. I cannot agree that that's what they did.

Mr. GUARINI. You don't think that that is what has happened, that the aberration that exists is because they competed for junk insurance in order to play the market, in order to play the high interest rates, where they were winners for a while, and then when they found out that it didn't work right, that they come before the public and reach into their pockets in order to make up for their losses?

Mr. JONES. Absolutely not, the way you characterized it. Absolutely not.

Mr. GUARINI. What blame do you share?

Mr. JONES. We acknowledged that we went through a competitive cycle, that it was forced on us by the capital that was available in the industry and the pricing of people that were endeavoring to increase their market share.

Mr. GUARINI. You didn't answer my question. What blame do you share? What recommendations can you make for cleaning up your own act as an industry? You pay virtually no income tax as an industry to the U.S. Government. You know that. And you have the best tax laws that allow you to put reserves together and get the floats and take advantage of sheltering away all of your potential losses which gives you an advantage that no other industry has. So you are a preferred industry. What can you do to show the Government——

Mr. JONES. That's not an advantage.

Mr. GUARINI [continuing]. That you as an industry are going to clean up your act?

Mr. JONES. That's not an advantage. That is the facts. And our history is that we do not set aside enough reserves, and we have to make up for them.

Mr. GUARINI. Do you pay any income tax to speak of as an industry? Aren't you one of the lowest industries in America as far as paying tax to the U.S. Government, to pay your share of our military responsibilities, of our domestic and social responsibilities in our country?

Mr. JONES. First, we pay large State taxes whether we make a profit or not.

Mr. GUARINI. That's not what I asked you. I asked you——

Mr. JONES. We pay a lot of property taxes.

Mr. GUARINI [continuing]. About the National Government. You pay very little or no National Government taxes.

Mr. JONES. There are major companies that pay no Federal taxes. Over a period of time ours has probably been lower than average, as you suggest, and——

Mr. GUARINI. If things are so bad in your industry, why are property and casualty companies among the hottest companies on Wall Street as far as new issues are concerned, and as far as takeovers are concerned? Why?

Mr. JONES. Because we are doing what we should do in increasing our premiums. We are responding to what our situation is, and there was no way to go but up. And those that analyzed the future have bought stocks on that basis.

Mr. GUARINI. So, therefore, you are one of the most favored industries on the street, and it is because you are inordinately raising the price of insurance that makes you that big profit picture that Wall Street looks to you for as a favored takeover; is that correct?

Mr. JONES. I would not agree to the characterization of it. We have increased prices substantially last year, but there are still needed increases.

Mr. GUARINI. Isn't it true in that regard to say that with the tort system we have that the workplace becomes safer and the products become safer as a result of the adversary system we have?

Mr. JONES. That was certainly one of the theories, but I don't think that that's an actual effect now. I do not think we get prevention from the awards.

Mr. GUARINI. You don't think that companies, knowing that they would have a higher responsibility to the public, would be more vigilant in the way that they make their finished products and sell their products, if they didn't feel that they could be held liable by our tort system? Is that correct?

Mr. JONES. They are responsible in what they are trying to do, and they endeavor to put safe products in the market. There are bad characters, but most of the people really try to put out the best products.

Mr. GUARINI. But it is a way of weeding out the dangerous and the bad products, is it not, to make them fully responsible, by a jury of peers to the person who is injured?

Mr. JONES. As a lawyer, that certainly was the theory of the fault system. But we have gotten far from the fault system. We have gone to the strict liability system, particularly in the areas in which you refer.

Mr. GUARINI. Well, let's take pain and suffering. You said you want to cap pain and suffering? A man's body is wracked or destroyed, a woman's body is injured very seriously; you think that in the adversary system where pain is portrayed before a jury, which is a jury of peers, that both the defendant and the plaintiff have an opportunity of presenting their side of the case, that we should not pay fully the pain and suffering that a person has gone through as a result of being a victim of an accident?

Mr. JONES. You are talking about injuries that are not remedied by dollars. There is no accurate measure of what should go with those things.

Mr. GUARINI. So you don't want to pay liquidated damages to a person, or you want to at least cap them, to see that he doesn't get fully what he is entitled to for pain and suffering?

Mr. JONES. Certainly everyone should cover all their economic losses, but the noneconomic losses have gotten out of hand. If the society wants to pay for them, they can be calculated in, but that will be a part of the increased cost of liability insurance.

Mr. GUARINI. What about if a person on the other side of pain and suffering has a loss of enjoyment of life, that he loses a leg in an accident and he enjoys playing tennis, he enjoys bowling, he enjoys participating in sports. Would you, under your theory, give him any award?

Mr. JONES. Would that be unlimited?

Mr. GUARINI. Would you give him any award? I don't know how you are going to limit it.

Mr. JONES. Well, yes, yes, yes.

Mr. GUARINI. You would give him an award?

Mr. JONES. Sure. But we are suggesting that if you want to control the cost of the liability system, that there should be caps on those things that——

Mr. **Guarini**. And how would you cap it, sir? As an industry, how would your industry cap pain and suffering and enjoyment of life?

Mr. **Jones**. No; the industry couldn't cap. It would have to be done through Government.

Mr. **Guarini**. Well, how could Government go about regulating the cap? I mean how would you characterize what should be done? If you got a recommendation, the Government were here to accept it from you, how does your industry provide a cap or says that a cap should be exercised on loss of enjoyment of life or pain and suffering?

Mr. **Jones**. In California in 1975, when they had a crisis with regard to medical malpractice insurance, they passed a cap of $250,000 on noneconomic loss, and that was sustained by the Supreme Court of the United States recently. It was supported by the Supreme Court of California and by the U.S. Supreme Court. They said you get your economic loss, but the noneconomic, we're going to put at the level of $250,000 being the maximum.

Mr. **Guarini**. So if a person has a herniated disk and he's 21 years of age, he would have the same cap as a person who is 60 years of age and has a herniated disk, even though he has to bear his pain 41 years longer? Is that your theory?

Mr. **Jones**. Same cap. I don't know whether there'd be the same award——

Mr. **Guarini**. Is that justice?

Mr. **Jones**. I don't know whether it would be the same award——

Mr. **Guarini**. Is that a just system of jurisprudence, in your mind?

Mr. **Jones**. It is a response to what society wants to pay for medical malpractice insurance.

Mr. **Guarini**. Well, let me ask you, do you think your portfolios, which are extensive, should the income from those portfolios be used to help to lower the insurance rates for the various underwritings that you have in your companies?

Mr. **Jones**. Yes, they are, increasingly they are.

Mr. **Guarini**. Should all the income be used in figuring out in the various States the cost of insurance to the public, taking fully into consideration the amount of money that you have made from your tax-free bonds and all the other interest and business investments you have in your portfolio?

Mr. **Jones**. The ordinary income from investments is one of the income streams and is considered by each company in determining their rates, and during this competitive period this was very much required by company policyholders that wanted it to be taken into consideration or, in the alternative, they would have created a captive insurance company so as to have that same result.

Mr. **Guarini**. It depends on the company itself? Is that right?

Mr. **Jones**. Yes.

Mr. **Guarini**. You are only regulated in regard to automobile rates normally. Are you regulated in many other rates throughout the States?

Mr. **Jones**. We are regulated by all rates, but some of them are by prior approval, and some of them are in retrospect. You file them and use them, and then they are reviewed. Some States——

Mr. **Guarini**. But the only place you are strictly regulated basically is automobile, as a general rule; is that correct?

Mr. **Jones**. As a general rule, that's probably true.

Mr. **Guarini**. And you virtually have carte blanche, a blank check, on all other kinds of casualty insurance, based upon your own sense of social conscience; is that right?

Mr. **Jones**. Well, no, there's a regulatory system——

Mr. **Guarini**. Oh, you file what the rate is.

Mr. **Jones**. Yes, you file it——

Mr. **Guarini**. And then the State has knowledge of it, so you give them notification.

Mr. **Jones**. You have just seen where intense competition regulates this. It's regulated the commercial area over the last 7 years.

Mr. **Guarini**. Well, you're not in much intense competition when all the companies are raising their rates four and six times over a previous year. I know some instances where the increase of rates, whether it be liability on buildings, or whether it be product liability, or whether it be malpractice, or whatever, has gone up many, many times. How do you figure there's competition there? They seem to all be rising with the tide and having a field day on the American public. How do you figure out there's competition under those kinds of circumstances?

Mr. **Jones**. They are adjusting for the failure to increase rates over the past. They are adjusting to what the rates should be now.

Mr. **Guarini**. Are they adjusting for mistakes the industry has made in the past?

Mr. **Jones**. And as I suggested, they are restricted in the capital available to meet all of the demand, and that's what you see. We describe it as a tight or restrictive market.

Mr. **Guarini**. Would you assess any fault on the part of your industry, sir?

Mr. **Jones**. I thought we acknowledged that we had gone through this competitive cycle that put us in a position where we were behind on increases and so that we have brought them forward.

Mr. **Guarini**. That's not acknowledging fault. Do you acknowledge any fault, any changes that have to be made within the industry to correct our system?

Mr. **Jones**. No; I have none to suggest.

Mr. **Guarini**. I figured that. Thank you.

Mr. McGrath.

Mr. **McGrath**. I want to get back to a point that I made previously. The job of regulating the insurance industry generally lies with State insurance departments. I was trying to find out whether or not the role of that insurance department more favored the solvency of the company or regulating premiums to individuals.

We understand that the ISO was recommending gradual increases in premiums over the last couple of years. That information was readily available to insurance commissioners in the State. I am just trying to find out if the response from those insurance commissioners was to say to the companies—we understand the intense competition that is going on in the industry, but we are also concerned about the availability of funds to meet the awards individuals may receive, and based upon your reduction in premiums as well as information from the ISO, it doesn't look to us like you are going to have enough money available to handle those awards.

Was that a response that you were getting from the insurance commissioners or insurance departments, or was their response one that indicated more interest about solvency of the company?

Mr. HUNTER. States are not equipped, sir, to handle regulation. Twenty-six States don't have actuaries, for example.

Mr. MCGRATH. That is interesting.

Mr. HUNTER. You should look at the GAO report from 1979, "Issues and Needed Improvements in the State Regulation of Insurance"—it is a very good report and I recommend it highly to the committee. In it you will find lots of problems in terms of competency and adequate staff, even the Conference of Insurance Legislators have said "while the state-of-the-art in computers is futuristic, the art of the States is an heirloom." The States are not equipped to handle solvency or regulation.

Mr. MCGRATH. If that is the case, should the Federal Government step in and say to the States, if you are going to be the regulators, these are the things that perhaps we want you to look at?

Mr. HUNTER. Yes, and to help them with certain things, like macroeconomic studies and the like. I think it would be a very helpful role.

Mr. MCGRATH. Mr. Jones.

Mr. JONES. I wanted to say that some of the States have done a very fine job of continuously regulating for solvency. I would speak of New York, California, Connecticut, Texas. They have a fine tradition. There are a few States that have gone through a period where the commissioners were known and identified as consumer commissioners and made it very difficult to make a profit in those States. Many companies have stayed out. I could name specific ones. New Jersey has had that history for many years. The current Governor has done a great deal to try to remedy it but hasn't gotten it done completely. Florida is suffering from consumer approach. Massachusetts at times has.

Mr. MCGRATH. I guess it is the approach——

Mr. HUNTER. We think we are suffering in the other States actually.

Mr. MCGRATH. I have no further questions, Mr. Chairman. I appreciate your indulgence.

Mr. GUARINI. Gentlemen, we want to thank you very much. I know it has been very spirited. We have had you here for 2 hours. We are trying to get to the bottom of finding out what created the crisis and what is wrong. We appreciate your indulgence and the advice you have been able to give the committee. I want to thank you very much.

Mr. JONES. We welcomed the opportunity to be with you.

Mr. GUARINI. Thank you, sir.

I would like to call Dr. Mark A. Peterson, Rand Corp., on behalf of the Institute for Civil Justice; William J. Anderson, Director of General Government Division, U.S. General Accounting Office, accompanied by Natwar M. Gandhi, the group director.

Gentlemen, we welcome you. As soon as you are able to get situated, we would appreciate having you submit your statements for the record and we will have the benefit of your remarks.

Mr. ANTHONY [presiding]. Dr. Peterson, your full statement has been accepted for the record. As Chairman Pickle admonished, we would like you to try to keep your opening statement to 5 minutes so we can have another round of spirited questions.

STATEMENT OF MARK A. PETERSON, SENIOR BEHAVIORAL SCIENTIST, INSTITUTE FOR CIVIL JUSTICE, THE RAND CORP.

Mr. PETERSON. Mr. Chairman and members of the Ways and Means Committee, my name is Mark Peterson. I am a lawyer and senior psychologist on the staff of the Institute for Civil Justice at the Rand Corp. Rand is a private nonprofit corporation that conducts public policy research. The Institute for Civil Justice was established in 1979 to conduct policy research on the civil justice system. The institute's research is supported primarily by corporate and foundation grants.

My testimony today deals only with one issue involved in the current concern about availability and cost of liability insurance. That is: How have lawsuits and civil jury verdicts changed in recent years. My testimony will draw primarily on the institute's research on civil jury verdicts, research that I have directed for 6 years.

The institute has assembled a statistical data base that tracks results of all civil jury trials held in Federal and superior State courts in Cook County, IL, and San Francisco, CA, between 1959 and 1984. The institute has published five reports describing trends in civil jury trials between 1960 and 1979 and will shortly publish two more.

Most of my testimony will draw upon these seven reports to describe trends and patterns in jury awards through 1979. I will note when my testimony is based on other data.

The Institute for Civil Justice's research shows two very different trends in the size of awards by juries. First, for the bulk of lawsuits tried to juries, verdicts did not increase during the 1960's and 1970's. After adjusting for inflation, the median or 50th percentile jury award remained almost constant both in Cook County and San Francisco; less than $20,000 during both decades.

Most jury trials involved slight or moderate injuries such as strains, sprains, or bruises suffered in vehicle accidents or slips or trips. Jury awards in these cases are virtually the same in the early 1960's as they were in the late 1970's.

Mr. GUARINI. Is that adjusting for inflation?

Mr. PETERSON. That is adjusted for inflation.

In contrast to this stability for most cases, large jury awards increased greatly, more than doubling during the 1970's. The average jury award and the total amount of money awarded by juries also doubled in the 1970's, but these increased only because large awards increased in size.

These differing trends seem to occur in part because jurors react differently to different types of lawsuits. Plaintiffs in product liability, malpractice, street hazard, and workplace accidents, types of lawsuits that I have described as high stakes lawsuits, received larger awards for the same type of injury.

For example, in Cook County in the 1970's, a plaintiff who was injured by malpractice received 3.5 times as much as a plaintiff who suffered similar injuries from a slip and fall. In San Francisco, a product liability plaintiff received twice as much as a plaintiff with similar injuries from a slip and fall.

Differences in compensation between high stakes and routine lawsuits have increased in recent years. These differences arose in part because juries made bigger awards against so-called deep pocket defendants—businesses, professionals, and Government agencies—who were usually the defendants in product liability—malpractice, street hazard, or workplace injury lawsuits.

Government or business defendants were typically assessed 30 to 50 percent more than individual defendants when plaintiffs had similar injuries in the same type of lawsuit.

This deep-pocket effect is even greater if plaintiffs' injuries were serious. Businesses then paid 2.5 times as much as individual defendants did in similar cases.

I should add also that our studies show that there is no deep-pocket effect on liability in most cases. Deep pockets are not more likely to be found liable than individual defendants. However, there is some evidence that when a plaintiff is seriously injured, that deep-pocket defendants are somewhat more likely to be found liable, but not invariably so.

Observers who view the civil justice system from different perspectives might reach different conclusions about what is happening because they focus on these two different trends. Those who participate in the system on a day-to-day basis, such as trial judges and lawyers, may see little change in jury verdicts because awards in most cases have not in fact changed. Insurance companies or self-insured companies that are frequently involved in litigation see great increases. They have to pay jury awards and the total and average of these awards has increased, driven by the increasing size of very large awards.

Our statistical analyses show that large jury awards increased at least in part because juries now award more money for certain cases. Jury awards to seriously injured plaintiffs, for example, those who lost a limb, were paralyzed or suffered burns or serious eye or ear injuries, doubled or tripled during the 1970's both in San Francisco and Cook County.

The average—mean—award to plaintiffs who lost a limb increased threefold in San Francisco and in Cook County; the wrongful death award increased 125 percent. Furthermore, juries in both jurisdictions increased awards for high stakes types of lawsuits—malpractice, products liability, street hazard, and work injury cases—regardless of the seriousness of plaintiffs' injuries in those cases.

Our preliminary analyses of jury awards in the 1980's indicates that the two separate trends in jury awards continue. Most jury awards still remain modest. The median or typical jury award apparently increased in San Francisco in the 1980's but the median award actually decreased in Cook County after adjusting for inflation.

In contrast, the largest awards continued to increase in both jurisdictions in the 1980's, growing even faster than they had during the previous decade. Average awards and the total amount of money awarded by juries increased by 50 percent in San Francisco and almost doubled in Cook County in the early 1980's, again because the large awards continued to increase greatly.

Increasingly the civil justice system seems to be two different systems. One, a stable system that provides modest compensation for plaintiffs who claimed slight or moderate injuries in automobile and other accidents that have been the major source of litigation for 50 years. The second, unstable system provides continually increasing awards for claims of serious injuries in any type of lawsuit and for all injuries, serious or not, in product liability, malpractice, street hazard, and workplace accidents.

Thank you.

[The prepared statement follows:]

STATEMENT OF MARK A. PETERSON, INSTITUTE FOR CIVIL JUSTICE, RAND CORP.

Mr. Chairman and members of the Ways and Means Committee, my name is Mark Peterson. I am a lawyer and senior psychologist on the staff of the Institute for Civil Justice at the Rand Corporation. Rand is a private, nonprofit corporation that conducts public policy research. The Institute for Civil Justice was established in 1979 to conduct policy research on the civil justice system. The Institute's research is supported primarily by corporate and foundation grants.

My testimony deals with one issue involved in the current concern about availability and cost of liability insurance: how have law suits and civil jury verdicts changed in recent years. Most law suits and civil claims settle without reaching trial, but those settlements seem to be influenced by the outcomes of law suits that are tried to juries. Consequently, as jury verdicts change, outcomes change not only for cases that go to trial but also for cases that settle.

My testimony will draw primarily on the Institute's research on civil jury verdicts, research that I have directed for six years. The Institute has assembled a statistical data base that tracks results of all civil jury trials held in Federal and superior state courts in Cook County, Illinois and San Francisco, California between 1959 and 1984.[1] The Institute has published five reports describing trends in civil jury trials between 1960 and 1979 and will shortly publish two more.[2] Most of my testimony will draw upon these seven reports to describe trends and patterns in jury awards through 1979.[3] I will note when my testimony is based on other data.

The Institute for Civil Justice research shows two very different trends in size of verdicts awarded by juries.

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[1] The data was obtained from jury verdict reporting services that are published in both jurisdictions. The Institute has also expanded the data base to include all verdicts in the State of California from 1980 through 1984.

[2] Peterson and Priest, 1982; Shanley and Peterson, 1983; Peterson, 1984; Chin and Peterson, 1985; Peterson, 1985; Peterson and Shanley, forthcoming; and Peterson and Chin, forthcoming.

[3] Data for the 1980s were added recently and only preliminary analyses of these data are now available.

First, for the bulk of lawsuits tried to juries verdicts did not increase during the 1960s and 1970s. After adjusting for inflation the median (or 50th percentile) jury award remained almost constant in both Cook County and San Francisco, less than $20,000 during both decades.[4] Most jury trials involved slight or moderate injuries--such as strains, sprains, bruises--suffered in vehicle accidents, or slips or trips. Jury awards in these cases were virtually the same in the early 1960s as they were in the late 1970s.

In contrast to this stability for most cases, large jury awards increased greatly, more than doubling during the 1970s. The average jury award and the total amount of money awarded by juries also doubled in the 1970s, but these increased only because large awards increased in size.

Increasingly, the civil justice system seems to be two different systems: One, a stable system that provides modest compensation for plaintiffs who claimed slight or moderate injuries in automobile and other accidents that have been the major source of litigation for 50 years.[5] The second, unstable system provides continually increasing awards for claims of serious injuries in any type of law suit and for all injuries, serious or not, in product liability, malpractice, street hazard and work place accidents.

These differing trends seem to occur, in part, because jurors react differently to different types of suits. Plaintiffs in product liability, malpractice, street hazard, and work place accidents--types of lawsuits that we describe as "high stakes" lawsuits--received larger awards for the same type of injury. In Cook County in the 1970s a plaintiff who was injured by medical malpractice received 3 1/2 times as much as a plaintiff with similar injuries from a slip and fall; in San Francisco a product liability plaintiff received twice as much as a plaintiff with similar injuries from a slip and fall. Differences in compensation between high stakes and routine law suits have increased in recent years.

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[4] All amounts are in 1979 dollars unless otherwise noted.

[5] See, Selvin and Ebener, 1984, An Institute study of 100 years of litigation in Los Angeles County.

These differences arose in part because juries made bigger awards against "deep pocket" defendants--businesses, professionals and government agencies-- who were usually the defendants in product liability, malpractice, street hazard or work place injury law suits. Government or business defendants were assessed 30 to 50 percent more than individual defendants to plaintiffs with similar injuries in the same type of law suit. This "deep pocket" effect was even greater if plaintiffs were serious injured: businesses then paid 2-1/2 times as much as individual defendants did in similar cases.

Observers who view the civil justice system from different perspectives might reach different conclusions about what is happening because they focus on these differing trends. Those who participate in the system on a day-to-day basis, such as trial judges and lawyers, may see little change in jury verdicts, because awards in most cases have not in fact changed. But insurance companies or self-insured companies that are frequently involved in litigation see great increases. They have to pay jury awards and the total (and average) of these awards has increased, driven by the increasing size of very large awards.

Million dollar verdicts provide a dramatic example of these trends. In San Francisco during the 1960s only five cases had a value of $1 million (in 1979 dollars), 0.3 percent of all cases in which plaintiffs received an award. The total amount of money awarded in these million dollar verdicts represented 8 percent of all money awarded to plaintiffs. During the 1970s, 26 cases (2.3 percent of all cases in which plaintiffs received an award) produced awards exceeding $1 million. These cases accounted for 30 percent of all money awarded in the first half decade and nearly half of all money awarded in the second half of the 1970s. Million dollar verdicts were less frequent in Cook County but the trends were similar. While we have not yet completed our analysis of data for 1980-1985, our preliminary results indicate that these trends are continuing. Although million dollar awards occurred in less than 4 percent of all cases won by plaintiffs during this period, they now account for roughly two-thirds of all money awarded to plaintiffs.

Our statistical analyses show that large jury awards increased at least in part because juries now award more money for certain cases. Jury awards to seriously injured plaintiffs--those who lost a limb, were paralyzed or suffered burns or serious eye or ear injuries--doubled or tripled during the 1970s in both San Francisco and Cook Counties. The average (mean) award to plaintiffs who lost a limb increased threefold in San Francisco (from $321,000 in the 1960s to $1.2 million in the 1970s). In Cook County, the average wrongful death award increased from $125,000 in the 1960s to $385,000 in the 1970s.

Furthermore, juries in both jurisdictions increased awards for high stakes types of lawsuits--medical malpractice, products liability, street hazard and work injury cases--regardless of the seriousness of plaintiffs' injuries in those cases. In both jurisdictions, malpractice plaintiffs in the 1970s received awards that were twice as large as malpractice plaintiffs received for similar injuries in the 1960s. Products liability and street hazard awards in San Francisco during the 1970s more than doubled awards for similar injuries in the 1960s. Cook County juries showed the same general pattern of change, but the rate of change was somewhat less.

Finally, large jury awards seem to be less predictable. Fewer large awards in the 1970s could be explained by our measures of the number, type, severity, or disability from injuries or the amount of medical expenses or lost income.

Our preliminary analyses of jury awards in the 1980s indicate that the two seperate trends in jury awards continue. Most jury awards still remained modest. The median or typical jury award apparenty increased in San Francisco in the 1980s, but the median award actually decreased in Cook County after adjusting for inflation. In contrast, the largest awards continued to increase in both jurisdictions in the 1980s, growing even faster than they had during the previous decade. Average awards and the total amount of money awarded by juries increased by 50 percent in San Francisco and almost doubled in Cook County in the early 1980s, again because the largest awards continued to increase greatly.

Increasingly, the civil justice system seems to be two different systems: One, a stable system that provides modest compensation for plaintiffs who claimed slight or moderate injuries in automobile and other accidents that have been the major source of litigation for 50 years.[6] The second, unstable system provides continually increasing awards for claims of serious injuries in any type of law suit and for all injuries, serious or not, in product liability, mlpractice, street hazard and work place accidents.

The number and size of punitive damage awards also increased substantially in both jurisdictions during the past twenty-five years. In Cook County the rate of increase rose sharply during the 1980s: the number of punitive damage awards doubled and the total amount of money awarded increased by 700 percent during this period.

Although punitive damage awards were volatile, the typical award remained small throughout most of the period and the total number of such awards in both jurisdictions was less than 200. Most punitive damage awards were made in cases involving intentional torts or business disputes rather than ordinary personal injury cases. Punitive damages were awarded in only eight product liability suits in both jurisdictions during the entire twenty-five year period. But in the past few years there has been rapid growth in the number and size of punitive awards in personal injury cases in Cook County.

Punitive damage awards against businesses increased both in number and amount in both jurisdictions and the rate of increase was particularly great in recent years. Both compensatory and punitive damage awards against business defendants were larger than awards against individual defendants. During the 1980s juries increased the amount of punitive damage awards against business defendants relative to plaintiffs' losses.

A substantial number of punitive damage awards were reduced after trial, as a result of settlement or judicial action. For 1980 trials resulting in punitive damage awards, across all closed cases (including those in which the original judgment was satisfied and those in which it was reduced) plaintiffs received 50 percent of the original verdict.

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[6] See, Selvin and Ebener, 1984, An Institute study of 100 years of litigation in Los Angeles County.

The Institute's data describe trends in two major urban jurisdictions; we cannot be certain that these trends applied throughout the nation. Nevertheless, the findings do suggest that these trends might apply more broadly. Trends in Cook and San Francisco Counties were strikingly similar and our most recent data collection shows similarities in awards during the 1980s to other jurisdictions in California.

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Mr. Guarini. Thank you very much, Mr. Peterson.

Mr. Anderson of the GAO, accompanied by Dr. Gandhi.

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY NATWAR M. GANDHI, GROUP DIRECTOR

Mr. Anderson. Good morning, Mr. Chairman. It is a pleasure to be here before you.

As you know, this testimony that we are offering today is based on work we did for your parent committee. In fact, we had a hearing here last July and both of you gentlemen are very clear in my mind from that time.

But in any event, Dr. Gandhi, as you may recollect, is a recognized expert in the taxation of the property/casualty industry, not so much on other matters affecting the industry, I want to make that clear.

What we are going to talk about here today is evidence that bears on the long-term profitability as well as the current profitability of the industry.

One thing that is immediately apparent is that the industry, in recent years, has changed its overall pricing strategy. Best, as you are aware of, produces many statistics on the industry's activities. And I am looking at a page now, from a recent report which I will submit for the record, which contains information on the industry combined ratio, from 1960 to 1984.

The combined ratio is the ratio of underwriting losses and expenses to underwriting income. Throughout most of the period, from 1960 through 1979, the combined ratio hovered about 100 percent. In many of those years, in fact, there was a profit from the underwriting side alone of property/casualty operations, without regard to investment income.

It would appear that around 1980 or so, perhaps in the late 1970's, there was a deliberate change in strategy and the decision was made and, in fact, industry officials have conceded as much, to try and take more benefit of the money that was passing through their hands and to obtain additional investment income.

There are two tables in my statement that I would like to refer your attention to. One is the very last page, which contains 12-year data on the industry's overall performance. And a couple of things become apparent there. First, over that 12-year period, the data shown would seem to support the fact that indeed this is a cyclic industry and you could see the very significant downturn in 1974, and then you can see the turnaround that seems to have occurred in 1985.

I think that is important to keep in mind, that this right now would appear to be a recovering industry. Mention was made earlier of the fact that the stock market seems to view the industry as having considerable potential, based on the movement of its stock price last year, which outpaced the market by far. Two analyses we have reviewed, one by Salomon Bros. and one by First Boston, both speak very glowingly of the prospects of the industry in coming years.

It is a fact that in 1985 that the industry did seem to turn the corner and make a profit where, unlike in 1984, investment gains again exceeded underwriting losses with the result that there was a net gain.

Now that was basically the sum of the information that we presented in the report.

One last thing, Mr. Chairman, we did calculate and present to you last July some information on 10-year aggregates for the industry. The point that we made there was that over a 10-year period, ending either in 1984 or 1985—either one of you choose—there were net gains of $75 billion by the industry. And you made the point a bit ago that over that same period, on those $75 billion of gain, there was actually a tax refund. And that sum was about $1.5 billion.

But in any event, I want to make one other point. I did some quick calculations back on the sidelines, there, as I saw where the committee's interests were lying. And I would like to speak to two lines of insurance, the malpractice and general liability.

And if you will indulge me and take a pencil, I can give you some numbers that would shed a little insight into this whole issue. I am going to give you 1984 figures. In 1984, premium income for the industry, according to Best's, from malpractice insurance was $1,775 million—almost $1.8 billion in premium income from malpractice insurance. The losses and expenses associated with malpractice coverage in that year were almost $2.8 billion. There was an underwriting loss of about $1 billion on malpractice coverage. Now the combined ratio for that particular line was about 160 percent. This means that losses and expenses exceeded premiums by 60 percent. However, the investment gains allocated to this line were approximately $750 million which reduced the net loss to approximately $300 million.

Now it is a fact that the industry probably would have, even if they had foreknowledge of what their expenses would have been, still perhaps priced malpractice insurance at something approaching the average combined ratio of 117 percent.

To make a long story short, Mr. Chairman—I think I will terminate it there—an 11-percent increase in the premiums for malpractice would have put the industry in the same posture with respect to the relationship of losses and expenses to premiums as for all of their lines generally.

I really do not know what to make of that fact, perhaps the difference reflects the unexpected losses associated with the court situation that was discussed earlier. But it appears that not unrationally the industries are seeking to drop or curtail their losses in those lines where there is great uncertainty. And I do not know what that does for the committee as it tries to sort out what is right and what is wrong.

Let me stop there, sir.

[The prepared statement follows:]

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are pleased for the opportunity to assist the Subcommittee in its deliberations on the subject of the insurance industry. We have been actively involved in this area for the past 6 years. In 1981 we reported to the Congress on taxation of life insurance companies, and in 1985 we reported on taxation of the property/casualty insurance industry. We have testified several times before House and Senate Committees and have provided them with additional information on related issues, including the financial status of the industry.[1]

It is this status that we will address in our remarks today. In this regard, I will provide some background information on property/casualty company pricing strategies, a financial overview of the industry, and the financial impact of certain liability insurance lines.

PROPERTY/CASUALTY COMPANY PRICING STRATEGIES

Basically, a property/casualty company derives its income from two areas: underwriting gains (the excess of premiums over claims and expenses) and investment gains. Because of investment gains, a property/casualty company can have net income even though its premium revenues alone are not large enough to cover claims and expenses.

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[1] See attachment I for list of GAO studies and testimony.

The ability to offset underwriting losses with investment income plays an important role in a company's pricing strategy--that is, the amount it charges for the insurance that it offers. For a number of years, many companies have been willing to accept lower premiums in order to compete for certain insurance lines, even though claims and expenses exceeded the premiums. As a result, claims and expenses in 1984 exceeded premium revenues by more than 18 percent.

The companies, however, expect to make up the premium shortfall through investment income. Through the incremental volume of premiums resulting from this pricing approach, companies are able to generate a larger amount of net cash flow which they can then invest to earn additional investment income. For instance, in 1983 the industry's claims and expenses exceeded premiums by about 12 percent, which produced an underwriting loss of about $11 billion. Even so, the industry had a net gain of about $8 billion and generated a total of about $12.1 billion in net cash flow, due to its pricing strategy and investment income.

In past years, investment gains, in the aggregate, have exceeded underwriting losses by a fairly wide margin. However, the gap has been narrowing in recent years and disappeared in 1984, when underwriting losses for the industry were $19.4 billion, while the investment gain was $17.9 billion. Some companies have reacted to this situation by sharply raising premiums.

FINANCIAL OVERVIEW OF THE PROPERTY/CASUALTY INDUSTRY

We developed a financial overview of the property/casualty insurance industry by studying financial data for the 10-year period, 1975 through 1984. We obtained these data from Bests' Aggregates and Averages. While Bests' reports omit figures for many small or new companies, we believe that the data are representative of the overall financial results of the property/casualty industry.

In tables 1 and 2 we show sources of income, broken out by underwriting gains, investment gains, and total gains. We also show disposition of income, broken out by the increase in surplus, dividends to stockholders, and the combined total. Federal income taxes are also shown.

We show in table 1 that, while property/casualty companies had about $46 billion in underwriting losses from 1975 through 1984, they also had about $121 billion in investment gains during this period, resulting in a net gain of about $75 billion for those years. From 1975 through 1984, federal income taxes were a negative $125 million, a rate of minus 0.2 percent of the net gain.

Table 1

All Companies -- Consolidated Basis
1975 through 1984
(in billions of dollars)

Underwriting gains (loss)	Investment gains	Net gains	Federal income tax	Percentage of federal income tax to net gains
($45.8)	$121.0	$75.2	($0.125)	(0.2)

Table 2 shows that about $48 billion of property/casualty companies' income from 1975 through 1984 was used to increase surplus, and $18.5 billion was paid to stockholders in the form of dividends.

Table 2

All Companies -- Consolidated Basis
1975 through 1984
(in billions of dollars

Increase in surplus	Dividends to stockholders	Total
$47.8	$18.5	$66.3

Tables 1 and 2 show that from 1975 through 1984 the industry as a whole, in spite of its underwriting losses, had positive net gains, yet had a negative federal income tax rate in relation to its net gains.

While firm figures for the industry's financial performance in 1985 are not yet available, Best's Insurance Management Reports, dated December 30, 1985, contains some estimates. For a number of reasons, including the pricing strategies referred to earlier, the underwriting losses in 1984 reached record highs and it appears that this will also be the case for 1985. However, as shown in table 3 below, the investment gains have also been increasing. The result is that the 10-year figures for 1976 through 1985 (based on estimated 1985 data) tell the same story of relatively high gains with overall negative taxes.

Table 3

All Companies -- Consolidated Basis
1976 through 1985
(in billions of dollars)

Underwriting gains (loss)	Investment gains	Net gains	Federal income tax	Percentage of federal income tax to net gains
($65.2)	$140.2	$75.0	($1.5)	(2.0)

It should be noted that the net gains, shown in table 3 for the 10-year period ending in 1985, are almost identical to those shown in table 1 for the 10-year period ending in 1984. However, because of the losses reported for tax purposes for 1985, the negative income taxes have risen from $125 million to about $1.5 billion.

Two explanatory notes about the above figures for investment gains and underwriting losses are appropriate. First, the investment gains include net investment income and both realized and unrealized capital gains. We recognize that unrealized gains may be wiped out in a following year. However, in compiling our figures we cover a 10-year period--a time frame sufficiently long to produce an average for those gains.

Second, the underwriting losses do not reflect policyholder dividends. We consider these dividends to be voluntary distributions by the companies.

The foregoing tables show that over the 10-year period, from 1976 to 1985, the investment gains of the industry exceeded the underwriting losses, giving the companies a net gain before taxes of $75 billion. However, it should be pointed out again that in the most recent years there has been very little, if any, excess of investment gains over underwriting losses.

Cyclical Nature of the Industry

While we believe it is important to look at the figures for the most recent years, we also believe that the industry is particularly subject to profit and loss cycles. For that reason we believe that data covering longer periods gives a more complete picture of the industry's profitability.

Unlike most other industries the property/casualty insurance industry is flexible with respect to capacity. When times are good, insurance companies can increase their capacity, take varied and greater risks, and generally lower their premium rates in order to achieve a greater market share. This results in a change from favorable premium profit margins to unfavorable margins, resulting in profit and loss cycles. Thus, the industry pricing strategy can result in financial cyclicity.

Attachment II shows the year-by-year figures for underwriting gains and investment gains for the 12-year period from 1974 through 1985. Column 1 in that table, underwriting gains, illustrates the cyclical nature of the industry. The earlier cycle bottomed out in 1975 and peaked in 1978. Since 1980, underwriting losses have mounted again but are estimated to have bottomed out in 1985.

Financial Outlook for the Industry Appears Favorable

From all indications it seems that the trend towards larger and larger underwriting losses has peaked. Industry estimates that have been made available to us show that over the next 5 years the industry expects substantial net gains. Our calculations, made from industry estimates, indicate an expected net gain before taxes of over $90 billion for the years 1986-1990.

Others also predict favorable prospects for the industry. An August 1985 study by Salomon Brothers, Inc.,[2] forecasts that premiums written will grow at a 12 percent annual rate over the 1985-1989 period. The same study forecasts a 10 percent growth rate for incurred losses over the period and improved underwriting results. The study forecasts further that industry profits will rise annually at a rate of 25 percent for 1985-1989 corporations over the same period. More recently, the Best's

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[2] Salomon Brothers, Inc., Property/Casualty Insurance Organizations, Five-Year Review and Outlook, 1985 edition, August 1985.

Insurance Management Reports, dated December 30, 1985, estimated that net premiums written in 1985 would increase by 21 percent over net premiums written in 1984.

IMPACT OF LIABILITY LINES

The lack of availability of property/casualty insurance does not apply across the board to all lines. Rather it is found principally in certain liability lines. These lines do not represent a major portion of the total property/casualty insurance business.

Two of the insurance lines often mentioned in the context of high premiums and lack of availability are medical malpractice and general liability. The following table shows, for the years 1984 and 1985, the relationship that these two lines have with respect to the total property/casualty industry.

Table 4

Financial Results
Property/Casualty Industry - 1984 and 1985
(in billions of dollars)

	Written premiums	Premiums as a percent of total industry	Under-writing losses[a]	Losses as a percent of total industry
Total Industry:				
1984	117.7	100.0	21.5	100.0
1985	142.3	100.0	25.2	100.0
Medical Malpractice:				
1984	$1.8	1.5	$1.1	5.1
1985	2.6	1.8	1.4	5.6
General Liability:				
1984	6.5	5.5	3.2	14.9
1985	11.1	7.8	4.6	18.3

[a] Underwriting losses after policyholder dividends.

The figures in this table show that these two lines represent a relatively small portion of the industry. The medical malpractice share of the industry's premiums is less than 2 percent and it constitutes about 5 percent of the industry's losses. Similarly, the general liability share of the industry's premiums is about 6 percent and it constitutes about 16 percent of underwriting losses. It should be noted, however, that for certain companies that specialize in these liability lines the percentage of the proportion of the losses will likely be higher.

It should also be noted that these two liability lines represent proportionately more of the industry's investment gains than of the industry's premiums. For example, medical malpractice lines constitute about 6 percent and general liability lines constitute about 14 percent of the industry's investment gains.

CONCLUSION

In conclusion, Mr. Chairman, available financial information for a recent 10-year period indicates that the property/casualty industry is cyclical in nature. The data further indicates that over this period the industry has been profitable. The profitability has been lower in more recent years; however, the industry projects increasing premium volumes and more favorable prospects for the next few years. The data also show that while medical malpractice and general liability insurance have received considerable attention recently, they represent a relatively small portion of the industry overall.

That concludes my statement Mr. Chairman. We would be pleased to respond to questions.

GAO STUDIES AND TESTIMONIES REGARDING THE INSURANCE INDUSTRY

September 1981 - December 1985

Reports and Fact Sheets

"Billions of Dollars Are Involved In Taxation of the Life Insurance Industry--Some Corrections in the Law Are Needed" (PAD-81-1, September 17, 1981)

"Modified Coinsurance and Its Use by Some Life Insurance Companies to Reduce Taxes" (PAD-82-33, April 14, 1982)

"Congress Should Consider Changing Federal Income Taxation of the Property/Casualty Insurance Industry" (GAO/GGD-85-10, March 25, 1985)

"Information on How the Property/Casualty Insurance Industry is Taxed" (GAO/GGD-86-16FS, October 16,1985)

"Information on the Stock and Mutual Segments of the Life Insurance Industry (GAO/GGD-86-31FS, December 12, 1985)

Testimony

March 18, 1982 on Life Insurance Taxation before the Senate Finance Committee

May 10, 1983 on Life Insurance Taxation before the Subcommittee on Select Revenue Measures, House Ways and Means Committee

June 13, 1983 on Property/Casualty Insurance Taxation before the Senate Finance Committee

May 17, 1985 on Property/Casualty Taxation, statement for the record for the Subcommittee on Economic Stabilization, House Banking, Finance, and Urban Affairs Committee

July 19, 1985 on Property/Casualty and Life Insurance Taxation before the House Ways and Means Committee

October 1, 1985 on Property/Casualty and Life Insurance Taxation before the Senate Finance Committee

UNDERWRITING GAINS, INVESTMENT GAINS, COMBINED UNDERWRITING AND INVESTMENT GAINS, AND FEDERAL INCOME TAX

ALL COMPANIES -- CONSOLIDATED BASIS

YEARLY 1974-1985

(In millions)

Year	(1) Under-writing gains	(2) Investment gains	(3) Total (1) + (2)	(4) Federal income tax
1974	(1,974)	(2,443)	(4,417)	(325)
1975	(3,653)	7,009	3,356	(555)
1976	(1,726)	7,173	5,447	148
1977	1,926	5,063	6,989	1,015
1978	2,548	7,758	10,306	1,389
1979	24	11,610	11,634	896
1980	(1,712)	15,870	14,158	593
1981	(4,464)	10,858	6,394	55
1982	(8,303)	18,387	10,084	(716)
1983	(11,088)	19,441	8,353	(1,218)
1984	(19,379)	17,875	(1,504)	(1,732)
1985*	(23,100)	26,200	3,100	(1,900)

*Estimate.

Chairman PICKLE. Well, we thank you, Mr. Anderson.

I would like to ask either one of you gentlemen for your comments on the amount of the jury or court award in a typical tort liability lawsuit; the number of high awards made; and the dollar range of such high awards.

I am trying to get a scope in the broad sense.

Mr. PETERSON. As I indicated in my testimony, we have done studies of jury verdicts for a period of 25 years in Cook County, IL and San Francisco. And the typical jury award in Cook County, in the Federal and Law Division—which is the superior State court there—the typical award is between $10,000 and $15,000. And that has been almost constant for the 25 years. That is in current dollars.

Once you adjust for inflation, it has been almost steadily that same amount of money in Chicago.

However, the average award in Cook County has increased steadily and, for example, in the period 1980 to 1984 the average jury verdict in Cook County was over $250,000. So although the typical award was only $10,000 to $15,000, the average was 15 to 20 times that large because of the occurrence of a few very extraordinarily large awards.

The pattern is somewhat similar in San Francisco, although the typical award in San Francisco during the most recent 5-year period—the median—was about $60,000. So the typical award there was somewhat greater than Cook County. But again, the average award was about four or five times as large in San Francisco.

Those large awards occur, in part, because of extraordinarily large awards. If you look at million dollar verdicts, those jury trials that produce an award of $1 million or more, they are infrequent. They occur in only about 3 to 4 percent of all the trials that plaintiffs win.

But during the most recent 5-year period that we have looked at, the early 1980s, two-thirds of all the money awarded by juries in Cook County were awarded in cases that produced million dollar awards. So there is this concentration of large awards in a very few number of cases, which obviously is substantially driving the exposure of insurance companies. And yet, that does not reflect the payments to most plaintiffs.

Chairman PICKLE. Are there any areas of the country where these large suits are more predominant than in others? Are the large suits more likely to occur on the west coast, the Southwest, Northeast, or is there any other geographic pattern?

Mr. PETERSON. Mr. Chairman, that is a hard question to answer, because there is not systematic information available for every jurisdiction in the country. We get our data from publications, jury verdict reporting services, that are published in those jurisdictions. There is one in Chicago and there are several in California. There are several in other jurisdictions in the country. But there is no national data base of information.

All I can answer is that in the jurisdictions we have studied that million dollar awards, very large awards, are infrequent in every California jurisdiction. They are infrequent in Chicago. But they tend to dominate the total amount of money.

My sense is that probably is pretty typical of urban and major industrial States. It is likely that in some of the smaller, less urban, States that there may not be quite as much of a predominance of these huge awards but nevertheless you still hear about them in Kansas and in Alabama and in a number of other States that certainly do not have the reputation that California or Illinois or New York have.

Chairman PICKLE. Mr. Anderson, does your study indicate any area of the country that is more likely to give these large rewards than other parts of the country?

Mr. ANDERSON. No, sir. We have not studied that aspect, so I cannot speak to it. The only thing we have noted is that the literature says that New Jersey, among others, is apparently a State of special concern to the industry as far as awards go.

Some other numbers that come to my mind as I am sitting here, on the aggregate situation, I read somewhere that in 1984 there were 401 liability settlements over $1 million.

Chairman PICKLE. 401?

Mr. ANDERSON. 401 over $1 million.

Chairman PICKLE. Over $1 million?

Mr. ANDERSON. Yes, sir.

And some other numbers that we have, again from the same source, jury verdicts, was that in the malpractice area the median award in 1984 was $200,000. The average award was $660,000 in 1984. So we are talking quite big money.

What I cannot tell you is how many—I know that there was a $660,000 average.

Chairman PICKLE. What was the median?

Mr. ANDERSON. $200,000. Unchanged since 1980. The median remained at $200,000 from 1980 to 1984. The average increased from $400,000 to $660,000. But I cannot even tell you how many cases that is. There is a dearth of information about the individual States, at least from my standpoint. We have not seen it yet.

I think you would really need it to understand exactly what is happening out there and why insurance carriers are behaving the way they do in different states.

Chairman PICKLE. I was not here to hear all of your testimony, but I want to ask you, even though you may have commented on it, whether it is either necessary or appropriate today for insurance companies to increase insurance premiums and/or to reduce coverage?

Mr. ANDERSON. It certainly would seem that if they were going to be consistent with their long range pricing strategy, which aimed apparently at having underwriting be self-sustaining, that they are incurring losses—significant losses—on underwriting generally. Although this has been offset generally, in recent years, by investment income from my standpoint I would say that there are certainly opportunities, room to increase the premiums on some of their lines.

There is a disparity. When you have 160 percent combined ratio for malpractice insurance and down around 102 or 103 percent for some of the other lines, it seems inconsistent.

Chairman PICKLE. Now the insurance industry takes the position that investment income is dropping while at the same time the amount of claims they must pay has increased. What is your response to their position on this?

Mr. ANDERSON. 1985 figures indicate that investment gains has increased one more time. In fact, investment has increased sufficiently so that—unlike 1984—they show a net gain for 1985. The projections of experts who study the industry say that this trend will continue, that investment income and premiums will both continue to rise.

Chairman PICKLE. Mr. Guarini, do you have any questions of the panel?

Mr. GUARINI. I am sorry I missed some of the testimony. But does GAO have an opinion as to the justifiability of what has happened in the insurance crisis, with the rates being raised enormously within the last year or so? Is it justified by your figures?

Mr. ANDERSON. Let me take two lines that I just developed some numbers on, malpractice and general liability. For malpractice, acting on 1984 experience, it would have taken an 11-percent increase in the premiums, in gross premiums, in order to have achieved the same overall results as on all the lines combined.

Mr. GUARINI. But when we average out, we are really deluding ourselves, are we not, because there is such a wide disparity between types of insurance and the judicial systems in each State. And when you start averaging out, you really get away from the truth. You are dealing with rounded out numbers instead of looking into the problem to see exactly what is causing this and where the problems are.

I imagine the results you may find in New Jersey may be different than they are in California. And then you get into the specific sector, whether it is product liability or automobile insurance or malpractice or whatever. Then again, depending upon the laws of the particular State, the judicial court system and the tort system and everything else, it is very hard to generalize. In fact, it is unfair to just throw numbers out.

Mr. ANDERSON. Let me express it in another fashion then, Mr. Guarini, if I can, sir. It would appear that if 1984 experience in malpractice and general liability, regarding premium income and loss and expense income, was an indicator of what could be expected in 1985 and 1986, then on that basis the industry could have increased premiums for those two lines by lesser percentages rather than cancelling coverage or increasing 300 or 400 percent—speaking aggregates, I must do that with respect to the individual lines.

Malpractice could have been increased 11 percent to give results similar to all lines. Let me go all the way; 20 percent would have given them a break even in malpractice. With respect to general liability, a 30 percent increase would have been needed to break even.

Now if, in fact, that was projectable—now obviously the industry sees an awful lot of uncertainty as to whether that experience would have been repeated in 1985 and 1986. I assume that is why they are refusing coverage and increasing rates significantly more than the statistics that I just cited.

Mr. GUARINI. Do we have, to your satisfaction, all the in-depth facts that you need in examining the portfolios and the modus operandi of all of these insurance companies to come to conclusions?

Are you satisfied that you have been able to accumulate the data so that you can make final judgments on the facts that you have been able to uncover?

Mr. ANDERSON. No, sir. We have too little insight into the pricing strategies of individual carriers, as to why it behooves them to cancel or not cover rather than—if, in fact, these numbers that I cite represent—as they do—the average of the industry. We don't know why an individual organization finds it more to its advantage to cancel or increase rates far disproportionate to the losses that were actually being incurred in the individual lines.

I feel that there is insufficient data about why the industry is behaving the way it does.

Mr. GUARINI. Is there a true competitiveness within the industry and the marketplace? It seems as though everybody has raised their rates inordinately to a very, very high level. And the bargaining power, as I understand, with the purchaser of the insurance is not really that great. It is OK. If you do not write us, then you will have to leave us.

Is the insurance company, in your opinion, competitive today with each other or is there evidence of collusion amongst them, as far as ratemaking is concerned?

Mr. ANDERSON. I do not profess to be an expert on that, sir. I can only cite the people themselves in the industry who say it is very competitive and that was one of the causes of the problems they found themselves in, last year.

Mr. GUARINI. As an expert, who has looked into the figures and the industry itself in-depth, could you voice an opinion as to whether or not you feel that there is a competitiveness that exists in the industry?

Mr. ANDERSON. I am going to turn to Dr. Gandhi and let him speak to that, if I may, sir.

Mr. GUARINI. Dr. Gandhi?

Mr. GANDHI. Well, sir, we do believe that in the early 1980's the industry was, indeed, very competitive particularly on the commercial side. We are not so sure as to why the industry felt the need to increase the rates so dramatically in 1985 and later because, as Mr. Anderson has pointed out, we see quite a rosy future for the industry as forecasted by independent observers.

Indeed, the projections for the operating profit for 1985 and 1986—I'm sorry, 1986, 1987, 1988 are quite good and maybe another look should be given to the extraordinary increase in the premiums as they are required now by the industry.

Mr. ANDERSON. Mr. Guarini, I am sure you are aware of the situation, but let me repeat it anyway. There was a factor occurring on the competitive front, during the early 1980s. First, in the reinsurance area, we had an awful lot of people try to get into that business who thought they saw a quick buck to be had with obtaining a lot of money to invest someplace.

We also had a lot—I guess a lot of people move into the property/casualty business, accounting for a large number of the insolvencies that are plaguing some parts of—plaguing the industry in any number of States.

So it would appear that there was some wild competition from unexpected sources from the stalwarts in the industry who, I presume, have run a pretty straight ship throughout this whole period.

Mr. **Guarini**. Was that a result of there being high interest rates and their desire to get money that they could invest into their portfolio, instead of being competitive in the insurance industry? The same results for the wrong reasons?

Mr. **Anderson**. That is what the literature says, sir. That is what these people say themselves, yes, what people in the industry said was driving behavior.

Mr. **Guarini**. So therefore they made mistakes in judgment, and they're trying to make up for it in 1 or 2 years; is that what we're saying—that they wrote junk insurance and garbage insurance just to get premiums, undercut each other, and then put it into the marketplace to get their 18 to 20 percent return? Is that what happened?

Mr. **Anderson**. Yes, sir. To make a long story short, when that combined ratio jumped from, say, 100 percent in 1979 to 118 percent in 1986, the reason was this competition for the dollar to invest.

Mr. **Guarini**. So therefore the final victim is the consumer, because then if they made mistakes of judgment or investment judgments or insurance practices that were not really standard practices or good, sound business practices, the victim is the consumer.

Mr. **Anderson**. Well, the point was made earlier, though, that you could look at it from the standpoint that their insurance coverage was underpriced during that period, as they actually were charging below cost in order to get their buck in our pocket.

Mr. **Guarini**. If I may, Mr. Chairman, just let me ask you, is there any suspicion of collusion among insurance companies regarding competitiveness that exists in the marketplace?

Mr. **Anderson**. I can't speak with any authority on that at all, sir.

Mr. Gandhi?

Mr. **Gandhi**. No, sir.

Mr. **Guarini**. You can't speak with any authority?

Mr. **Anderson**. I'm sorry. I have no idea, sir.

Mr. **Guarini**. You have no idea, OK. Thank you.

Chairman **Pickle**. Mr. McGrath?

Mr. **McGrath**. Gentlemen, your testimony indicates, as we all know, that the sources of income for a PC would be underwriting gains and their investment gains. Now we all recognize what was going on in the last 6 years. I think it's been milked to death here.

I'm still interested in the point I was previously pursuing regarding the States' role in premiums. Does your testimony cover the point I previously made that the ISO recommendations were for gradual premium increases, while the companies were reducing them?

Mr. **Gandhi**. We did not specifically address that particular issue, but it is our understanding that the ISO recommendations were ignored by the industry.

Mr. **McGrath**. And then I guess the question of whether or not that was prudent is a matter of some subjectivity, based on the competing forces.

I'm interested in the roles of the regulators in watching out for this kind of an occurrence and what their reactions were to this kind of pricing policy. I'm wondering whether or not your study shows any indication that they were aware of this pricing policy, whether they felt it was important or whether or not they did anything about it?

Mr. **Anderson**. We in GAO didn't examine into that at all, sir.

Mr. **Peterson**. No, we have not studied anything with regard to the State regulation.

Mr. **McGrath**. Thank you, Mr. Chairman.

Chairman **Pickle**. I believe Mr. Guarini has one additional question.

Mr. **Guarini**. May I ask the panel or particularly Mr. Anderson and Dr. Gandhi, what kind of information do you actually need to determine if the premiums that have been charged lately are justified and whether there is, in truth, competition in the industry?

Mr. **Anderson**. You would have to get into the books of some representative companies, in my opinion, Mr. Guarini, if you wanted any real assurance in understanding why they priced particular lines the way they did and why it was necessary, say, to a 500-percent increase as opposed to some different number. I'd have to understand what their pricing strategies were and really what underlay it.

Mr. **Guarini**. Therefore it can be ascertained?

Mr. **Anderson**. Yes, sir.

Mr. **Guarini**. And did you ask for any of this information?

Mr. **Gandhi**. No, we have not, sir.

Mr. **Guarini**. Could you ask for this information if you wanted to do a study on it?

Mr. **Anderson**. Obviously it would have to be voluntary. I mean, GAO certainly has no right of access, no legal right of access to the books and records of those organizations, especially since they are State regulated, and we don't even have a Federal entree from a regulatory standpoint.

I would hope that some of these companies could be persuaded. What I'd love to do is develop an audit program, so to speak, an information request that could be submitted by the company, perhaps, to the industry to have some representative organizations complete.

Mr. **Guarini**. I think that would be central to the whole argument and the whole sense of the hearings that we have here, whether or not there is competition.

Dr. Gandhi?

Mr. **Gandhi**. Yes. I would like to add one point that Mr. Anderson had alluded to earlier, which is about these various lines. In our testimony in table 4 on page 7, the major problem area, the medical malpractice and general liability about which the whole crisis is being talked about, the medical malpractice is just about a little less than 2 percent of the industry's premiums, and it accounts for about 5 percent of the industry's total losses.

Mr. **Guarini**. You mean the payout in judgments is only 2 percent of the premiums?

Mr. **Gandhi**. No. The premium that is being paid in medical malpractice lines is just about a little less than 2 percent of the entire industry's premium, and the losses that the insurance industry has incurred in the medical malpractice lines is about 5 percent of the industry's overall losses.

So what we are suggesting here is that the importance that is attached to medical malpractice should be viewed in a proper perspective of the entire industry. And if you are to look at the general liability lines, sir, you would also see there that the premium dollars again are around 8 to 9 percent of the overall premiums, and the losses that are sustained in general liability lines are around 16 percent of the entire industry's losses.

So if you are to look at the entire industry, then these two lines about which there appears to be the crisis or there is talk about the crisis, that these two lines are relatively small in proportion in the whole industry.

Mr. GUARINI. Well, would the losses from large judgments be more indigenous to certain States than to other States because of the body of law that exists in that State as to malpractice?

Mr. GANDHI. At least the incidents that we have heard about and the court cases that are being reported, yes, there are certain States in which there is a larger incidence of these cases than others.

Mr. GUARINI. So maybe we should correct the states that have the problem instead of saying that the 50 States have a problem. If only a few States have created a situation, maybe we should spend some time examining what's wrong within those few States.

Mr. ANDERSON. It's another example of missing data, Mr. Guarini.

Mr. GUARINI. I know. Thank you, gentlemen.

Chairman PICKLE. Mr. Schulze?

Mr. SCHULZE. Yes, thank you, Mr. Chairman.

Dr. Peterson, I would like to elicit from you, your personal opinion of the relationship between the insurance availability crisis that we have now and the need for reform in our civil justice system?

Mr. PETERSON. Well, certainly one of the arguments that underlies the increasing rates and justifications for them is the argument that payouts have increased. I think there's a question if the increase in rates are more than enough to compensate for the increasing payouts that are occurring in liability. I can't speak to that. But certainly jury awards are increasing, and in particular lines the increases are greater. They're greater in medical malpractice, certain subareas within the general liability lines. Product liability exposure seems to be increasing more. There are particular kinds of insureds that are experiencing greater increases. Government agencies, State and local governments are experiencing greater losses in payouts in awards against them, and insurance rates are increasing more there.

So there certainly is—presumably there's a relationship between these, that as the average and the total amount of money that's paid out increases, it necessitates some rate increase.

Whether the present increases are enough, too much, not enough is not something I can not speak to.

Mr. SCHULZE. But your experience doesn't lead you to say that reform of the civil justice system would have a major impact on the existing system?

Mr. PETERSON. One of my colleagues at the Institute for Civil Justice has looked at the effects of several reforms in the malpractice area, including caps on general damages, periodic payments, limitations of attorneys' fees and so forth, and has found that some of those do have some impacts upon the payouts, both the number of settlements or awards that are paid as well as their size.

For example, I believe that the caps, some form of cap, either general damages or across the board, may have an effect of reducing the total payouts by around 20 percent. That is a rough study, and it's a difficult area to do research in, and it's an approximation.

Other kinds, there were somewhat smaller effects from other reforms. So the answer to that is, yes, it appears that changes in the substantive tort law could reduce these awards, and then caps are probably an area that would make a fairly large impact, because, as we see, the total payout is being driven by a few very large awards.

Mr. SCHULZE. Doctor, I talked to a company whose insurance company had to pay an $11 million award. As a result, their insurance was canceled, and they are unable to get any insurance.

That's what led me to think tort reform would make a great impact. But you don't think it's going to be as great as that one case might make it seem?

Mr. PETERSON. Well, the empirical evidence, which is the basis from which I'm speaking, the studies that have been done in this area have been fairly limited, and they suggest—well, the 20-percent reduction in the payout, if that gets translated into premiums, is not an insubstantial change, and that's from one change in the law in one area of law. So I think——

Mr. SCHULZE. It's substantial, but it might not be dramatic. It's part of the overall fabric of the problem.

Mr. PETERSON. It doesn't sound like it's going to create 500-fold changes, no.

Mr. SCHULZE. Thank you, Doctor. Thank you, Mr. Chairman.

Mr. GUARINI. Mr. Chairman, I just want to ask the Rand Co. who commissioned the study and whether or not insurance companies contribute any sums of money in regard to the studies being completed?

Mr. PETERSON. Let me answer your second question first. The Institute for Civil Justice is supported primarily by the private sector. It's one of the few programs at Rand that isn't supported primarily by the Federal Government.

And the support for this area comes primarily from corporations. About half of the funding for the Institute for Civil Justice comes from——

Mr. GUARINI. I only asked whether or not insurance companies contributed to the study?

Mr. PETERSON. Yes. They contribute about half the total amount of money.

Mr. GUARINI. Do any consumer organizations contribute to the other half or any part of the other half?

Mr. **Peterson**. There are some foundations and unions. I don't know of any consumer organizations.

Mr. **Guarini**. The fact is, insurance companies have contributed half the amount of money, that you came forward with the study that you are giving us today; is that correct?

Mr. **Peterson**. Yes, although I should indicate that the decision about the particular studies that are done are not determined by the insurance companies. They and everyone else that contributes give us a pool of money and we decide what research——

Mr. **Guarini**. I'm not doubting the credibility of your study. I'm just trying to find out where the funds come from.

Mr. **Peterson**. Sure.

Mr. **Guarini**. For you to do the work that you've done, and you've answered it.

Mr. **Peterson**. Certainly.

Chairman **Pickle**. Thank you, gentlemen. I think that concludes the questions for this panel. We appreciate your testimony.

Now the Chair would ask that the Honorable Lyndon Olson and Senator Grant Jones please come to the witness table.

The Chair is particularly pleased to recognize and welcome these two gentlemen. Mr. Lyndon Olson is chairman of the Texas State Board of Insurance. He is here to present testimony on behalf of the National Association of Insurance Commissioners. The Honorable Grant Jones is our Texas State senator, and he appears today on behalf of the National Conference of State Legislatures.

Both of these gentlemen are two of the most respected public officials and officers in our State government. I think they are recognized nationally by virtue of the fact that they are appearing today on behalf of the National Association of Insurance Commissioners and the National Conference of State Legislatures.

I will give you a personal welcome. We are pleased to hear your testimony. Commissioner Olson, why don't you start first?

STATEMENT OF LYNDON L. OLSON, JR., CHAIRMAN, TEXAS STATE BOARD OF INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. **Olson**. Thank you, Mr. Chairman. My name is Lyndon Olson, Jr. I am the chairman of the Texas State Board of Insurance, and past president of the National Association of Insurance Commissioners.

Just for the purpose of making some statements in a few minutes, I have been chairman of the reinsurance task force of the National Association of Insurance Commissioners for the last 5 years. I have enjoyed about as much of regulating as I can stand. Let me assure you, Mr. Chairman and members of the committee, Senator Jones and I didn't even know that each other was going to be here this morning so it is totally coincidental that we are representing our separate national organizations.

Mr. Chairman, I would like to submit my testimony for the record. For the sake of brevity, I will try to make some observations about what in the world is going on. What I do professionally and every day, 7 days a week, 365 days a year is regulate insurance companies.

I know the clamor and the hammer that you all are feeling up here. If you can take an exponential approach to what you are getting here and apply it to a State as large as Texas, we as regulators are dealing with the conflicts every day and frankly have been dealing with them for the last 2 years. This is not something that has just occurred in the last 4 or 5 months.

First of all, in my judgment, everybody wants to blame everybody for everything that is going on. I perceive a lot of forces coming to bear. No. 1, the insurance industry has been immensely irresponsible. Their greed generally always overcomes their fear and that is what has happened in the past 6 or 7 years. They have been undisciplined as to underwriting for the last number of years. If you look at an organizational chart of an insurance company, you will generally see that the marketing arm and the investment arm overcame the underwriting arm of the insurance industry.

We are seeing a collision between those forces and the forces of "tort reform," where we have a number of special interests, properly so, blaming each other for everything. I think very simply the insurance industry competed itself into the ground. In listening to the testimony this morning, it is very clear that you all understand what happened cyclically, economically, relative to interest rates.

Investment income, in my judgment, while it is not exponential as it was over the last 6 to 7 years, investment income is up but it is more linear. The swing is not as great, but it is more linear.

Let me, if I may, in the next few minutes, because I understand the time limitation—I brought with me something that might be helpful. Please understand that I have been a legislator and I understand the political forces that you deal with. I'm a regulator. I don't believe I am a social architect. I have opinions about certain things.

I would like to try to show you essentially if you were attempting to identify—let's forget tort reform just a second—let's forget anomalies in our culture about the fact that we are a risk-taking nation but the commercial world wants to be insured against every peril known to man today. I can philosophize about that. I would like to show you a practical reinsurance transaction and basically what happens to every constituent that you have that has a commercial liability policy.

I have heard names mentioned this morning by individuals from Arkansas, New York, and Texas. Mr. Chairman, I've got a phone number but it is mine and I am going to send your staff a phone number to tell your constituents to call. The problem is your office has been in touch with mine so many times I think they know exactly where I live.

Every constituent that you all have that has a commercial general liability policy, for the purposes—I apologize that I don't have an easel—for the purposes of conversation, I will refer to as the insured. They have 100 percent of the potential risk, a doctor, a hospital, a day care center, a long haul trucker, a director and officer liability, a mom and pop ownership, a barbershop, a city, municipality, a political subdivision, an environmental exposure, products liability exposure, general liability risk, 100 percent of that risk is insured with an unilateral contract by an insurer.

It is at that point where we begin to run into problems. Most folks say, and let's use Aetna, it starts with an "A," and I'm not advertising for anybody, the Aetna is on the hook for 100 percent of that insured's potential exposure, which in the general liability lines is great. The insurer looks at that risk and says, this is a long tailed risk with vast exposure, environment, pollution, whatever it may be, and so they in turn say, we are not going to and can't for the premiums that we are getting, absorb the risk, the 100-percent exposure of the insured. They in turn reinsure a premium, a price, to assume let's say 80 percent of the risk. Aetna keeps 20 percent. Lloyds of London, the London market, Brazil, wherever. They will in turn take 80 percent of the 100 percent of the insured.

In every transaction, like in the banks or savings and loans selling commercial paper, the risk is transferred. The reinsurer, being Lloyds of London, assumes 80 percent of the 100 percent of the insured and Lloyds says in this instance, we can only absorb 40 percent of the 100 percent of this risk, so we are going to retrocede to some sheik in Kuwait, Japan, Brazil, but we are going to keep 40 percent and we are going to pay an ultimate retrocessioneer or a reinsurer a premium, we the reinsurer to another reinsurer.

My dear friend Al Lewis in New York who is superintendent of insurance in New York, Al says, it is laying off bets. That is all it is in country boy language.

This is where the problem is occurring. This is called capacity. The crisis today is not private passenger automobile. The crisis today is in the very large insurance risks that have very large potential exposures and literally hundreds of billions of dollars ultimately are reinsured, otherwise our domestic companies could not absorb that.

When the pricing is inadequate, the reinsurer did the same thing the primary insurer did. They competed themselves into the ground. They took advantage of high interest rates. Interest rates came down. The reinsurers said, we ain't taking no more of that until we get an adequate price. The capacity that I talked about constricted and the constriction in the economic cycle made its way back to our Nation and our domestic insurers and ultimately the insured.

I think that is a proper portrayal of what is going on and what has happened.

[The prepared statement follows:]

LYNDON L. OLSON, JR., CHAIRMAN
TEXAS STATE BOARD OF INSURANCE
U.S. HOUSE OVERSIGHT SUB-COMMITTEE OF THE WAYS AND MEANS COMMITTEE
WASHINGTON, D.C.
MARCH 13, 1986

It is an honor to appear before you today and to discuss with you some very serious problems in the area of liability insurance.

These are problems with which I have become all-too-familiar in our state--and which I have spoken about and written about at great length during the last several months.

A crisis atmosphere surrounds the insurance industry today.

The industry's cries of pain have been heard throughout this country. Companies have gone out of business, and others are on the brink.

Consumers are hurting, too. They are hurting bad, and they have let us who regulate the industry know about it in no uncertain terms.

All of this, of course, is not altogether unfamiliar in a cyclical business known for its periodic up's and down's.

There is good news and bad news to bring you today.

The good news is that the crisis appears to be easing in some respects.

The bad news is, that for some, it may get worse before it gets better, and sweeping changes are going to be required in the interest of economic stability for this nation.

The insurance industry's problems mirror deep-seated and alarming facts about our society and our culture at large.

Most of these problems concern the property/casualty field-and particularly commercial property and general liability lines of insurance.

Business and professional people all over America know this scenario very well, indeed:

--Many are faced with 200 per cent, 300 per cent, even 1,000 percent jumps in premiums for less coverage than they had last year.

--Others have seen coverage in "risky" lines of liability cancelled at mid-term, or they have been denied renewals on short notice.

Key problem areas, where prices have soared out of sight, or the market has constricted sharply include:

Commercial multi-peril property insurance (apartments, office buildings, townhouses), environmental liability (toxic waste, etc.), directors and officers financial liability, municipal liability, child care center liability, medical malpractice liability and products liability.

Workers' compensation is also a disaster area, and attorneys, accountants, architects, even ministers, have joined the doctors in lamenting the cost of their professional liability coverage.

The property/casualty industry is reacting to an unbroken string of underwriting losses dating back to 1979.

The climax came last year, when the industry's losses from the business of writing insurance policies plummeted to a record $21.3 billion. Even with investment income, pretax operating income was a negative $3.8 billion. Net income after tax was less than $1.5 billion. Preliminary figures for 1985 indicate a pretax operating loss of $5.5 billion, and net income after tax of about $1.7 billion.

We are seeing a sharp increase in insurance company failures. Our list of companies in receivership in Texas has lengthened to about 75, and others are on the brink.

National Association of Insurance Commissioners examiner teams identify more than 200 life companies and as many property/casualty companies as "in need of immediate regulatory attention." that means they flunked four or more test criteria and are in danger of becoming insolvent. And nearly 350 others are borderline and need to mend their ways.

Insolvencies get very big very fast. Regulators must move faster and more firmly, and their tools must be equal to an age of massive computerization. Examiners with No. 2 pencils and green eyeshades can no longer keep up with industry development--in insurance, banking or other modern financial institutions.

The insurance industry historically operates in a boom-bust cycle. That is a demonstrable fact.

The cycle is, in part, a symptom of irresponsibility and lack of discipline. It is, in large part, the result of sheer greed. Recovery from the bust end of the cycle--and that's where the industry is today--begins when fear overcomes greed.

In boom times, companies compete themselves into the ground. So it was in the expansively-prosperous 70's.

Insurance companies eagerly priced their products at bargain basement levels to attract more money for investments.

As long as interest rates were soaring, cash-flow underwriting prevailed. There was a helter-skelter race for premiums and market share.

Then, as we all know, interest rates faltered and dipped. Last year, for the first time since the current cycle began, the investment income of insurers did not overcome the underwriting losses.

Now, we see the industry--trying to extricate itself from its predicament--again hiking its prices and, where it can, getting rid of marginal business any-which-way.

Historically, the nation has seen these scenes played out for a hundred years--with varying degrees of severity.

Today's trauma for insurers has been exacerbated by several factors.

--The phenomena of the late 70's and 80's included new forces: massive environmental disasters (such as escaping toxic wastes), previously little known industrial diseases (like asbestosis, silicosis and others) and rampant child abuse.

--Concurrently, and inescapably related, the litigation explosion developed and intensified. People began suing each other over every conceivable kind of injury or wrong.

They sued for medical malpractice, product failure or imperfection, job injuries or illnesses that did not develop for a decade or more after accident or exposure, hair dryers that singed as well as dried, autos that burned on rear end collision.

--As plaintiffs won on more and more liability issues, judges and juries became increasingly generous with awards. Multi-million dollar verdicts became commonplace.

--All of this contributed to another complication of global proportions--a crisis of capacity in reinsurance.

Reinsurance has been compared with bookies laying off their bets. It is a form of insurance for insurance companies--a mechanism for spreading risk more widely by enabling one insurance company to assume part of a major obligation written by another.

Few understand reinsurance. Without it, the insurance business, as we know it, could not operate.

Primary insurers retain only a small portion of major risks--say 20 per cent--and reinsure the remaining 80 per cent in the international market for a premium. Reinsurers, in turn, keep perhaps 40 per cent and "retrocede" the rest at lesser premium to other reinsurers and investors.

Sixty-five per cent of the reinsurance in this country is obtained from the London market.

Lloyd's of London Chairman Peter Miller has warned repeatedly during recent months that world reinsurance markets are increasingly wary of business bearing a "made in America" label.

Insurance companies and their reinsurers are in the dark as to how our courts will interpret policy wording. Therefore, says Mr. Miller, they are unable to project with any certainty just what they are accepting liability for.

There is widespread concern with lack of limits to liability and excessive awards by juries. A drive for major reform of tort laws dealing with injuries or wrongs to individuals is being mounted.

Serious efforts are underway at state and federal levels to place limits on liability.

Meanwhile, reinsurers are saying this to us, quite bluntly:

"Unless changes are made, we don't want your business anymore. We don't know what your rules are."

And they are talking about taking their investment to other countries, like Japan, where risk is more predictable.

The significance of this, of course, is that, where reinsurance is not available, insurance companies simply cannot afford to accept the largest and riskiest of risks.

Who can, single-handedly, insure a Bopal, a Love Canal, toxic waste, a nuclear explosion?

I am an insurance regulator--not a social architect...I am no longer a legislator, although I once was a part of that process and still have a deep empathy for it.

It is not my business to take the plaintiffs' bar to task or to take up arms with the tort system reformers.

As a citizen, however, I cannot ignore the impact on the nation's economy of spectacular increases in punitive, non-economic, non-injury related damages.

As both an insurance regulator and a citizen, I must take notice of the fact that insurance companies, partly due to an unpredictable judiciary, are now refusing to provide financial protection for certain types of business.

Some, caught in the dilemma of availability vs. affordability of insurance, have turned to self-insurance, but with varying degrees of satisfaction--and adequacy. The risk for smaller firms is high.

Captives, mechanisms formed by firms to meet their own insurance needs, are risky, too, and have brought losses to many companies that experimented with them in the '70's.

A variety of "rescue" proposals have been proposed in the states, where insurance regulatory authority rests.

--Voluntary market assistance programs have been proposed in New Hampshire, Pennsylvania and Illinois to increase the availability of coverage for commercial risks. We have adopted such a program in Texas within recent weeks.

--In Illinois, Gov. James Thompson has signed legislation prohibiting arbitrary or unilateral cancellation of casualty insurance (with certain exceptions).

--Commissioner Evans in Georgia has issued a directive requesting commercial lines insurers to give policyholders 60 days notice of non-renewals or renewals contingent on steep premium increases.

--In Ohio, Gov. Richard Celeste approved an emergency regulation prohibiting cancellation of certain types of policies.

--In New Jersey, Gov. Thomas Kean issued a 90-day order requiring insurance department approval before companies could cancel liability policies for municipalities, schools and businesses; and the state's superior court of appeals rejected the insurance industry's plea to revoke the order. It has now expired, but I understand a permanent regulation restricting cancellations is contemplated.

In such times, there are always those who would turn to the federal government for the answers--for new regulation.

I am not among them. At this point, I see no need for federal intervention.

Federal regulation has merely complicated problems in other areas of business. It has not prevented 106 commercial banks from failing this year. In banking, obviously, federal supervision has been no guarantee of solvency for the smallest or the largest institutions.

The states continue to believe that regulation is best when it is closest to the people.

State regulators of insurance, however, are constantly assessing ways to improve their operations and to provide greater safeguards.

On the other hand, the federal government is responsible for determing if we are discharging our duties adequately.

In our culture, we have attempted to insure ourselves against every peril known to man.

Because insurance is identified with human needs and the quality of life, consumers and the framers of public policy have looked to it increasingly for solutions to society's major ills. In a sense, the insurer has come to be expected to pay for the social conscience of a nation.

At times, certainly, insurance has been called on to perform functions no longer consistent with the pure private enterprise approach--to provide services which even violate sound business principles.

This phenomenon is reflective of a broader pattern in our culture.

For two decades, we have been witnessing a social development referred to by some as the "psychology of entitlement." That notion is based on a concept of a world in which everyone is entitled to good housing, good diet, and good jobs, good pay, good health care, good pension benefits--all as a matter of right, and without regard to ability to pay.

Today, people are beginning to realize the cookie jar is not bottomless.

In spite of the theory of "entitlement," we do not live in a risk free world, and we never will.

"Until the day when our institutions can be trusted to serve us as fiduciaries and when we can be educated to understand the limitations of the world we have constructed, litigation will remain the hallmark of a free and just society," wrote Jethro Lieberman in his book The Litigious Society.

Victims of negligence, suffering, tragic experiences deserve economic recompense. Litigation must always be relied on to resolve difference between parties. But the system must not lose its sense of reasonableness. And litigation must not be permitted to have an adverse impact on society.

There are signs of a let-up in the property/casualty insurance crisis.

--The industry has raised $5 billion in new capital this year, and its stock prices have jumped 22 per cent since mid-1984, compared to a 10 per cent rise in the Dow Jones industrial index.

--Higher rates are being implemented in problem lines, and there is evidence of a return to discipline in underwriting, new marketing concepts and practices and expense control.

--Insurers are rethinking their priorities--and placing the business of insurance ahead of investment.

--Companies which have maintained their discipline and their strong loss reserves remain on solid ground.

Hopefully, in another year to a year and a half, the market will have righted itself and regained its strength. But some types of coverage may never again be available--and certainly not at the old prices.

Chairman **Pickle**. I thank you, Mr. Olson. I know you didn't get to finish all your testimony. Perhaps we will get to come back. At this point, we will ask Senator Jones to make his statement and then we will open it up for questions and for further comments on your part.

Mr. **Guarini**. May I just ask what those two yellow suns were?

Mr. **Olson**. Yes, sir. The yellow is for the agent. Most folks when they take out an insurance policy, you say, who is your insurance with and they say Pete Thompson Agency. The agent merely is the facilitator of this commercial transaction. The broker or the intermediary or the managing general agent is the second circle, that is essentially the producer of the business, between the reinsurer and the primary insurer. The reason the broker is important is another issue and that is the issue of collectibility of reinsurance.

One thing that no one has addressed and we can get into that in a little bit is what happens when you have poor or lack of or inadequate security in the international reinsurance market and the chickens come home to roost on you and you don't have any place for them. We can go into that later if you choose.

Chairman **Pickle**. Senator Jones.

STATEMENT OF HON. GRANT JONES, SENATOR, TEXAS STATE LEGISLATURE, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, ACCOMPANIED BY R. MICHAEL BIRD, STAFF DIRECTOR, GOVERNMENT OPERATIONS AND REGULATIONS

Mr. **Jones**. Thank you, Mr. Chairman. My name is Grant Jones, State senator representing the 24th District in Texas. I am chairman of the senate finance committee and currently serving as cochairman of the joint interim committee on liability insurance and tort law and procedure reform. I am appearing here today on behalf of the National Conference of State Legislatures and its committee on government operations and regulation of which I am a member.

As most of you know, the National Conference of State Legislatures is the official representative of the Nation's 7,461 State lawmakers. The organization provides the legislatures of all 50 States with basic issue research, technical assistance, comprehensive Federal budget and funding data and training services for legislators and their staffs. The NCSL also serves as the Washington liaison for all State legislatures. NCSL's Federal-State assembly has adopted policies on a range of issues including liability insurance availability and affordability.

I appreciate the opportunity to appear before you today to share with you our concerns with respect to the significant disruption which has occurred in the liability insurance market.

The unavailability and cost of liability insurance is a national and even international problem to which State legislators are responding to expeditiously. Many States, including Maryland, Washington, Colorado, Arizona, and Michigan have completed interim study reports. Several others, including New York and Illinois as well as Texas, currently have task forces, commissions or special study groups surveying the extent of the problem and weighing the potential impact of proposed solutions.

NCSL has made liability insurance one of its top priorities and has published several reports and held several nationwide seminars and public meetings on the subject.

More than 1,200 pieces of legislation related to this issue are pending in the 43 State legislatures in session. Selective summaries of legislative action accomplished to date are attached. Taken together, these bills present a wide array of potential solutions to the problems facing us.

In Texas, our joint committee has thus far completed 3 full days of public hearings, and while there is substantial work yet to be done before the Texas Legislature convenes in January of 1987, we are able to draw some preliminary conclusions as to the causes of the availability and affordability problem in the liability insurance market.

Both public sector and private sector organizations face severe problems finding affordable liability insurance. Many organizations have been faced with midterm cancellations and nonrenewals. Certain lines of insurance have risen so high as to make the insurance in effect unavailable. Although insurance is a cyclical industry, this crisis is more severe than crises we have faced in the past. It is the simultaneous coming together of many problems which makes this crisis more severe.

Insurers have been experiencing increasingly severe negative loss ratios which are no longer being offset by their investment income. Decreasing investment income, according to insurers, has necessitated higher premium rates.

The drying up of the reinsurance market has necessitated even higher rates to compensate for the fact that insurers are unable to cede part of their risks to the reinsurers. Reasons cited for the reluctance of reinsurers to continue in the liability market is the unpredictability of our civil jurisprudence system. They seemingly prefer to contract to insure more predictable risks in jurisdictions other than the United States.

The private sector, small business specifically, has been hard hit by the crisis. Some entrepreneurs and service providers unable to get insurance have lost their licenses to do business. Almost every business and nonprofit organization is touched in some way and many are severely impacted.

The public sector has been directly affected. State and local governments are broadly exposed to liability and insurance problems given the range of governmental activities. As a recent Pennsylvania House of Representatives report stated:

> . . . insurance market economics and dynamics appear to be ill suited to deal with the special social and political status of municipal entities.

Although a State or locality may be financially healthy, it still may not have the resources to be engaged in lengthy and costly court battles.

Thus, States and localities are a target, a deep pocket, which can be pressured to settle. State and local governments have also become a more attractive target with the loss of sovereign immunity. Only seven States retain the full protection of sovereign immunity today; Alabama, Arkansas, Delaware, Kentucky, North Dakota, Virginia, and West Virginia. Total immunity for municipalities exists in only four States; Arkansas, Delaware, Ohio, and Virginia.

State and local officials and units of government have rarely had problems obtaining insurance coverage. Even when our legislature abrogated the doctrine of sovereign immunity, it limited rights to recovery to occurrences involving the operation of a motor vehicle and capped recovery at $100,000. Extension and imposition of unlimited liability on State and local government by the Congress is causing many units of government to seek self insurance, as they either cannot buy coverage or do not have sufficient revenues to conduct their operations and pay insurance premiums.

The Congress needs to examine the problems of determining some maximum limits for recoveries against State and local governments in individual or class action suits involving civil rights questions and environmental problems, at least to the extent of allowing only actual damages and eliminating damages which are speculative and emotional.

State regulatory practices and resources have come into question. Control over rate setting and effective oversight of insurers appears to run the entire quality gamut. To what extent regulators alone could have prevented or tempered this crisis is a matter which virtually every State is exploring.

Increased litigiousness and greater total dollar claims payments have somewhat compromised predictability within an industry where predictability has usually been difficult to gauge. Mix this with the need to provide reasonable compensation to injured parties, ensure due process and equal protection of the law, and you have a major challenge.

In our jurisprudence today, the theory that an innocent injured party could recover for his medical cost, loss of earnings, property damage and reduced earning capacity resulting from permanent disability has long been ignored, and the scope of recovery extends as far as the imagination can blossom.

Within the past 3 years, the Texas Supreme Court has abrogated a century-old doctrine of wrongful death cases, permitting recovery by a mother of emotional damages allegedly resulting from the death of a teenaged son. This in spite of a 20-year history of the legislature refusing favorable action on such a theory of recovery.

The court has begun to assess prejudgment interest against defendants dating from the occurrence. Again, the legislature had refused such a law. And most recently, the court allowed recovery for a potential right of inheritance, though the plaintiff had not even pleaded such a theory.

The extension of the theory of unlimited punitive damages again presents the insurer with no way of anticipating potential losses based on the emotions of a particular jury. Exemplary damages have nearly always been based on the theory of a defendant exhibiting such a total disregard for another's safety as to be tantamount to a willful act. Rules of review prohibit even the showing of some care before an appellate court, leaving, again, the assessment of punitive damages to the emotions of a given jury.

It is easy to understand why reinsurers consider our civil jurisprudence system unpredictable in the field of tort law. This is a problem which must be addressed by the individual States, and we in Texas are in that process.

[The prepared statement follows:]

STATEMENT OF SENATOR GRANT JONES, TEXAS LEGISLATURE, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

GOOD MORNING. MY NAME IS GRANT JONES, STATE SENATOR REPRESENTING THE 24TH DISTRICT IN THE TEXAS LEGISLATURE. I AM CHAIRMAN OF THE SENATE FINANCE COMMITTEE AND AM CURRENTLY CO-CHAIRMAN OF A JOINT INTERIM COMMITTEE ON LIABILITY INSURANCE AND TORT LAW AND PROCEDURE REFORM. TODAY, I AM APPEARING ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES AND ITS COMMITTEE ON GOVERNMENT OPERATIONS AND REGULATION OF WHICH I AM A MEMBER.

AS MOST OF YOU KNOW, THE NATIONAL CONFERENCE OF STATE LEGISLATURES (NCSL) IS THE OFFICIAL REPRESENTATIVE OF THE NATION'S 7,461 STATE LAWMAKERS. THE ORGANIZATION PROVIDES THE LEGISLATURES OF ALL 50 STATES WITH BASIC ISSUE RESEARCH, TECHNICAL ASSISTANCE, COMPREHENSIVE FEDERAL BUDGET AND FUNDING DATA AND TRAINING SERVICES FOR LEGISLATORS AND THEIR STAFFS. THE NCSL HAS ALSO SERVES AS THE WASHINGTON, D.C. LIAISON FOR ALL STATE LEGISLATURES. THE NCSL'S STATE-FEDERAL ASSEMBLY HAS ADOPTED POLICIES ON A RANGE OF ISSUES INCLUDING LIABILITY INSURANCE AVAILABILITY AND AFFORDABILITY.

I APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO SHARE WITH YOU OUR CONCERN WITH RESPECT TO THE SIGNIFICANT DISRUPTION WHICH HAS OCCURRED IN THE LIABILITY INSURANCE MARKET.

BRIEF REVIEW OF STATE ACTION

THE UNAVAILABILITY AND COST OF LIABILITY INSURANCE IS A NATIONAL AND EVEN INTERNATIONAL PROBLEM TO WHICH STATE LEGISLATORS ARE RESPONDING EXPEDITIOUSLY. MANY STATES, INCLUDING MARYLAND, WASHINGTON, COLORADO, ARIZONA AND MICHIGAN HAVE COMPLETED INTERIM STUDY REPORTS. SEVERAL OTHERS, INCLUDING NEW YORK AND

ILLINOIS AS WELL AS TEXAS CURRENTLY HAVE TASK FORCES, COMMISSIONS OR SPECIAL STUDY GROUPS SURVEYING THE EXTENT OF THE PROBLEM AND WEIGHING THE POTENTIAL IMPACT OF PROPOSED SOLUTIONS. NCSL HAS MADE LIABILITY INSURANCE ONE OF ITS TOP PRIORITIES AND HAS PUBLISHED SEVERAL REPORTS AND HELD SEVERAL NATIONWIDE SEMINARS AND PUBLIC MEETINGS ON THE SUBJECT.

MORE THAN 1,200 PIECES OF LEGISLATION RELATED TO THIS ISSUE ARE PENDING IN THE 43 STATE LEGISLATURES IN SESSION. SELECTIVE SUMMARIES OF LEGISLATIVE ACTION ACCOMPLISHED TO DATE ARE ATTACHED. TAKEN TOGETHER, THESE BILLS PRESENT A WIDE ARRAY OF POTENTIAL SOLUTIONS TO THE PROBLEMS FACING US.

IN TEXAS, OUR JOINT COMMITTEE HAS THUS FAR COMPLETED THREE FULL DAYS OF PUBLIC HEARINGS, AND WHILE THERE IS SUBSTANTIAL WORK YET TO BE DONE BEFORE THE TEXAS LEGISLATURE CONVENES IN JANUARY OF 1987, WE ARE ABLE TO DRAW SOME PRELIMINARY CONCLUSIONS AS TO THE CAUSES OF THE "AVAILABILITY - AFFORDABILITY" PROBLEM IN THE LIABILITY INSURANCE MARKET.

SCOPE OF THE PROBLEM

BOTH PUBLIC SECTOR AND PRIVATE SECTOR ORGANIZATIONS FACE SEVERE PROBLEMS FINDING AFFORDABLE LIABILITY INSURANCE. MANY ORGANIZATIONS HAVE BEEN FACED WITH MID-TERM CANCELLATIONS AND NON-RENEWALS. CERTAIN LINES OF INSURANCE HAVE RISEN SO HIGH AS TO MAKE THE INSURANCE IN EFFECT UNAVAILABLE. ALTHOUGH INSURANCE IS A CYCLICAL INDUSTRY, THIS CRISIS IS MORE SEVERE THAN CRISES WE HAVE FACED IN THE PAST. IT IS THE SIMULTANEOUS COMING TOGETHER OF MANY PROBLEMS WHICH MAKES THIS CRISIS MORE SEVERE.

- INSURERS HAVE BEEN EXPERIENCING INCREASINGLY SEVERE NEGATIVE LOSS RATIOS WHICH ARE NO LONGER BEING OFFSET BY THEIR INVESTMENT INCOME. DECREASING INVESTMENT INCOME, ACCORDING TO INSURERS, HAS NECESSITATED HIGHER PREMIUM RATES.

- THE DRYING UP OF THE REINSURANCE MARKET HAS NECESSITATED EVEN HIGHER RATES TO COMPENSATE FOR THE FACT THAT INSURERS ARE UNABLE TO CEDE PART OF THEIR RISKS TO THE REINSURERS. REASONS CITED FOR THE RELUCTANCE OF REINSURERS TO CONTINUE IN THE LIABILITY MARKET IS THE UNPREDICTABILITY OF OUR CIVIL JURISPRUDENCE SYSTEM. THEY SEEMINGLY PREFER TO CONTRACT TO INSURE MORE PREDICTABLE RISKS IN JURISDICTIONS OTHER THAN THE UNITED STATES.

- THE PRIVATE SECTOR, SMALL BUSINESS SPECIFICALLY, HAS BEEN HARD HIT BY THE CRISIS. SOME ENTREPRENEURS AND SERVICE PROVIDERS, UNABLE TO GET INSURANCE, HAVE LOST THEIR LICENSES TO DO BUSINESS. ALMOST EVERY BUSINESS AND NONPROFIT ORGANIZATION IS TOUCHED IN SOME WAY AND MANY ARE SEVERELY IMPACTED.

- THE PUBLIC SECTOR HAS BEEN DIRECTLY AFFECTED. STATE AND LOCAL GOVERNMENTS ARE BROADLY EXPOSED TO LIABILITY AND INSURANCE PROBLEMS GIVEN THE RANGE OF GOVERNMENTAL ACTIVITIES. AS A RECENT PENNSYLVANIA HOUSE OF REPRESENTATIVES REPORT STATED: "...INSURANCE MARKET ECONOMICS AND DYNAMICS APPEAR TO BE ILL-SUITED TO DEAL WITH THE SPECIAL SOCIAL AND POLITICAL STATUS OF MUNICIPAL ENTITIES." ALTHOUGH A STATE OR LOCALITY MAY BE FINANCIALLY HEALTHY, IT STILL MAY NOT HAVE THE RESOURCES TO BE

ENGAGED IN LENGTHY AND COSTLY COURT BATTLES. THUS, STATES AND LOCALITIES ARE A TARGET - A DEEP POCKET - WHICH CAN BE PRESSURED TO SETTLE. STATE AND LOCAL GOVERNMENTS HAVE ALSO BECOME A MORE ATTRACTIVE TARGET WITH THE LOSS OF SOVEREIGN IMMUNITY. ONLY 7 STATES RETAIN THE FULL PROTECTION OF SOVEREIGN IMMUNITY TODAY (ALABAMA, ARKANSAS, DELAWARE, KENTUCKY, NORTH DAKOTA, VIRGINIA, AND WEST VIRGINIA). TOTAL IMMUNITY FOR MUNICIPALITIES EXISTS IN ONLY 4 STATES (ARKANSAS, DELAWARE, OHIO AND VIRGINIA).

STATE AND LOCAL OFFICIALS AND UNITS OF GOVERNMENT HAVE RARELY HAD PROBLEMS OBTAINING INSURANCE COVERAGE. EVEN WHEN OUR LEGISLATURE ABROGATED THE DOCTRINE OF SOVEREIGN IMMUNITY, IT LIMITED RIGHTS TO RECOVERY TO OCCURRENCES INVOLVING THE OPERATION OF A MOTOR VEHICLE AND CAPPED RECOVERY AT $100,000. EXTENSION AND IMPOSITION OF UNLIMITED LIABILITY ON STATE AND LOCAL GOVERNMENT BY THE CONGRESS IS CAUSING MANY UNITS OF GOVERNMENT TO SEEK SELF-INSURANCE, AS THEY EITHER CANNOT BUY COVERAGE OR DO NOT HAVE SUFFICIENT REVENUES TO CONDUCT THEIR OPERATIONS AND PAY INSURANCE PREMIUMS.

THE CONGRESS NEEDS TO EXAMINE THE PROBLEMS OF DETERMINING SOME MAXIMUM LIMITS FOR RECOVERIES AGAINST STATE AND LOCAL GOVERNMENTS IN INDIVIDUAL OR CLASS ACTION SUITS INVOLVING CIVIL RIGHTS QUESTIONS AND ENVIRONMENTAL PROBLEMS, AT LEAST TO THE EXTENT OF ALLOWING ONLY ACTUAL DAMAGES AND ELIMINATING DAMAGES WHICH ARE SPECULATIVE AND EMOTIONAL.

- STATE REGULATORY PRACTICES AND RESOURCES HAVE COME INTO QUESTION. CONTROL OVER RATE-SETTING AND EFFECTIVE OVERSIGHT OF INSURERS APPEARS TO RUN THE ENTIRE QUALITY GAMUT. TO WHAT EXTENT REGULATORS ALONE COULD HAVE PREVENTED OR TEMPERED THIS CRISIS IS A MATTER WHICH VIRTUALLY EVERY STATE IS EXPLORING.

- INCREASED LITIGIOUSNESS AND GREATER TOTAL DOLLAR CLAIMS PAYMENTS HAVE SOMEWHAT COMPROMISED PREDICTABILITY WITHIN AN INDUSTRY WHERE PREDICTABILITY HAS USUALLY BEEN DIFFICULT TO GAUGE. MIX THIS WITH THE NEED TO PROVIDE REASONABLE COMPENSATION TO INJURED PARTIES, ENSURE DUE PROCESS AND EQUAL PROTECTION OF THE LAW AND YOU HAVE A MAJOR CHALLENGE.

IN OUR JURISPRUDENCE TODAY, THE THEORY THAT AN INNOCENT INJURED PARTY COULD RECOVER FOR HIS MEDICAL COSTS, LOSS OF EARNINGS, PROPERTY DAMAGE, AND REDUCED EARNING CAPACITY RESULTING FROM PERMANENT DISABILITY HAS LONG BEEN IGNORED AND THE SCOPE OF RECOVERY EXTENDS AS FAR AS THE IMAGINATION CAN BLOSSOM. WITHIN THE PAST THREE YEARS, THE TEXAS SUPREME COURT HAS ABROGATED A CENTURY OLD DOCTRINE IN WRONGFUL DEATH CASES PERMITTING RECOVERY BY A MOTHER OF EMOTIONAL DAMAGES ALLEGEDLY RESULTING FROM THE DEATH OF A TEEN-AGE SON. THIS, IN SPITE OF A TWENTY YEAR HISTORY OF THE LEGISLATURE REFUSING FAVORABLE ACTION ON SUCH A

THEORY OF RECOVERY.[1] THE COURT HAS BEGUN TO ASSESS PRE-JUDGEMENT INTEREST AGAINST DEFENDANTS DATING FROM THE OCCURRENCE. AGAIN, THE LEGISLATURE HAD REFUSED SUCH A LAW.[2] AND, MOST RECENTLY, THE COURT ALLOWED RECOVERY FOR A POTENTIAL RIGHT OF INHERITANCE, THOUGH THE PLAINTIFF HAD NOT EVEN PLEADED SUCH A THEORY.[3]

THE EXTENSION OF THE THEORY OF UNLIMITED PUNITIVE DAMAGES AGAIN PRESENTS THE INSURER WITH NO WAY OF ANTICIPATING POTENTIAL LOSSES BASED ON THE EMOTIONS OF A PARTICULAR JURY. EXEMPLARY DAMAGES HAVE NEARLY ALWAYS BEEN BASED ON A THEORY OF A DEFENDANT EXHIBITING SUCH A TOTAL DISREGARD FOR ANOTHER'S SAFETY AS TO BE TANTAMOUNT TO A WILLFUL ACT. RULES OF REVIEW PROHIBIT EVEN THE SHOWING OF "SOME CARE" BEFORE AN APPELLATE COURT, LEAVING, AGAIN, THE ASSESSMENT OF PUNITIVE DAMAGES TO THE EMOTIONS OF A GIVEN JURY.

IT IS EASY TO UNDERSTAND WHY REINSURERS CONSIDER OUR CIVIL JURISPRUDENCE SYSTEM UNPREDICTABLE IN THE FIELD OF TORT LAW. THIS IS A PROBLEM WHICH MUST BE ADDRESSED BY THE INDIVIDUAL STATES, AND WE, IN TEXAS, ARE IN THAT PROCESS.

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[1] SANCHEZ VS. SCHINDLER, SUPCT, 651 SW^2 249 APRIL 27, 1983, REHEARING DENIED, JUNE 15, 1983.

[2] CAVNAR VS. QUALITY CONTROL PARKING, SUPCT, 678 SW^W 548 JUNE 7, 1984.

[3] YOWELL ET AL VS. PIPER AIRCRAFT, SUPCT, CAUSE NO. C-3405 FEBRUARY 5, 1986.

STATE REMEDIES

THE SOLUTIONS BEING DISCUSSED AND IMPLEMENTED BY STATES ARE EXCEPTIONALLY VARIED. SOME, AS MARKET ASSISTANCE PLANS, APPEAR TO BE SHORT-TERM REMEDIES. OTHERS, SUCH AS SELF-INSURANCE PLANS OR RISK POOLING, MAY PROTECT GOVERNMENT AND THE PRIVATE SECTOR FROM INSURANCE CYCLES. TORT REFORM INITIATIVES MIGHT TEMPER LOSSES AND BRING SOME SENSE OF PREDICTABILITY TO UNDERWRITING. I USE TERMS AS "MAY", "APPEAR" AND "MIGHT" BECAUSE NOTHING LOOMS AS AN ABSOLUTE CERTAINTY AT THIS STAGE OF THE CRISIS.

A LENGTHY ROSTER OF ALTERNATIVE SOLUTIONS EITHER BEING DISCUSSED OR ALREADY IN PLACE AMONG THE STATES IS ATTACHED. I SUBMIT THIS LIST NOT TO PRODUCE A LONGER PIECE OF TESTIMONY BUT RATHER TO APPRISE YOU OF THE DIVERSITY OF APPROACHES BEING PURSUED. NCSL IS REVIEWING THE INCIDENCE WITH WHICH EACH OF THESE IS APPEARING AND ATTEMPTING TO DOCUMENT WHAT IMPACT, BOTH SHORT-AND LONG-TERM, THESE POTENTIAL REMEDIES MAY HAVE ON AVAILABILITY AND AFFORDABILITY OF LIABILITY INSURANCE. THIS IS A TEDIOUS ENDEAVOR WITH UNCERTAIN OUTCOMES AT THIS POINT.

STATE/FEDERAL ROLE

AS YOU ARE WELL AWARE, THE REGULATION OF THE INSURANCE INDUSTRY HAS TRADITIONALLY BEEN THE PROVINCE OF THE STATES. I BELIEVE THAT THE STATES HAVE DISCHARGED THEIR REGULATORY AUTHORITY IN THIS AREA IN A REASONABLE MANNER. I SEE NO COMPELLING REASON TO SUPERSEDE THE STATES' AUTHORITY IN THIS AREA WITH A FEDERAL REGULATORY SCHEME. FOR ONE THING, INSURANCE CONTRACTS ISSUED IN ANY

GIVEN STATE MUST, BY NECESSITY, CONFORM TO THE BASIC PROVISION OF STATE LAW. LAWS WHICH DIFFER MUST, OF NECESSITY, RESULT IN INSURANCE CONTRACTS WHICH DIFFER. AND, THIS, IN TURN, RESULTS IN DIFFERING RATE STRUCTURES. CONSEQUENTLY, IN MY VIEW, THE OPTIMUM LEVEL OF REGULATORY EFFICIENCY MUST REST AT THE STATE LEVEL.

WHILE I DO BELIEVE THAT THIS PRESENT CRISIS IS A SERIOUS ONE, NCSL BELIEVES THAT THE STATES ARE CAPABLE OF RESOLVING PRESENT PROBLEMS. FEDERAL INTERVENTION FROM NCSL'S PERSPECTIVE, WOULD BE PREMATURE AT THIS POINT. THIS IS NOT A DISMISSAL OF FUTURE NEED FOR FEDERAL ACTION SHOULD STATES PROVE UNABLE TO COMPLETELY RESOLVE ALL ASPECTS OF AVAILABILITY AND AFFORDABILITY PROBLEMS.

NCSL ALSO BELIEVES THAT THE FOLLOWING STEPS ALSO NEED TO BE TAKEN:

- TAKE CORRECTIVE ACTION AT THE FEDERAL LEVEL IN AREAS, AS ENVIRONMENTAL LIABILITY INSURANCE, TRUCKERS' COVERAGE AND THE PRICE-ANDERSON ACT, WHERE THE FEDERAL GOVERNMENT ALREADY HAS JURISDICTION.
- COOPERATE WITH ORGANIZATIONS AS NCSL AND OTHER LOCAL AND STATE GOVERNMENTS AND THEIR ORGANIZATIONS TO IDENTIFY REMEDIES WHICH WILL POTENTIALLY WORK TO ENSURE THAT SITUATIONS AS WE HAVE TODAY DO NOT RECUR.
- CONTINUE HEARINGS SUCH AS THESE WHICH CAN HEIGHTEN THE UNDERSTANDING OF THE EXISTING CRISIS AND PROVIDE A FORUM FOR REMAINING CURRENT ON STATE DEVELOPMENTS.

I CAN ASSURE YOU THAT THE NCSL WILL COOPERATE WITH YOU IN EVERY WAY IN YOUR DELIBERATIONS ON THIS ISSUE. I WANT TO THANK YOU AGAIN FOR AFFORDING ME THIS OPPORTUNITY TO PARTICIPATE IN THESE HEARINGS.

Attachment 1

STATE REMEDIES

1) REGULATORY INITIATIVES:

- PROHIBITIONS AND RESTRICTIONS ON MIDTERM CANCELLATIONS AND NONRENEWALS.
- REQUIRING PRIOR APPROVAL OF RATES RATHER THAN FILE AND USE ARRANGEMENTS.
- JOINT UNDERWRITING ASSOCIATIONS.
- MARKET ASSISTANCE PLANS.
- MODIFICATION OF OPEN COMPETITION RATING ACTS.
- UPGRADING STATE INSURANCE DEPARTMENT MANPOWER AND RESOURCES.
- REQUIRING RATES TO REFLECT LOSS EXPERIENCE.
- UTILIZATION OF "CLAIMS MADE" RATHER THAN "OCCURRENCE BASED" POLICIES.
- IMPROVED REGULATION OF NEW ENTRANTS.
- REGULATION OF SURPLUS LINE PROVIDERS.
- REQUIRING SUBMISSION OF DATA REGARDING INCIDENCE AND SEVERITY OF CLAIMS LOSSES.
- LOWERING "SURPLUS" RATIOS FOR SPECIFIC LINES OF COVERAGE.
- LIMITING THE PERCENTAGE AMOUNT WHICH AN INSURER CAN VARY RATES FROM THE FIXED RATE.

2) RISK MANAGEMENT:

- o ESTABLISH RISK RETENTION POOLS FOR CERTAIN LINES OF COVERAGE.
- o STRENGTHEN DISCIPLINARY PROCEDURES IN ALL STATE AGENCIES REGULATING PROFESSIONS.
- o ENHANCE HAZARD MANAGEMENT AND PUBLIC SAFETY.
- o STRENGTHEN RISK ASSESSMENT TECHNIQUES.

3) MARKETPLACE INTERVENTION:

- o LIMIT POLICY EXCLUSIONS.
- o AUTHORIZE BANKS AND THRIFTS TO ENGAGE IN INSURANCE ACTIVITIES.
- o REVIEW THE NEED FOR MANDATORY COVERAGE AND MANDATED LEVELS OF COVERAGE.
- o RESTRICT ANNUAL PREMIUM INCREASES/DECREASES BASED ON EVIDENCE OF CHANGE IN RISK.
- o REQUIRE NOTICE TO INSUREDS REGARDING CANCELLATIONS AND/OR NONRENEWALS.
- o PROVIDE EXCESS PROFITS STANDARDS.
- o ESTABLISH OR EXPAND RISK POOLING AUTHORITY.
- o ESTABLISH OR EXPAND STATE REINSURANCE, BACK-UP INSURANCE AND SELF-INSURANCE PROGRAMS.
- o PROHIBIT SURPLUS LINE PROVIDERS UNLESS APPROPRIATELY LICENSED.

4) TORT REFORMS:

- ESTABLISH COURTS OF CLAIMS TO HEAR SUITS AGAINST GOVERNMENT DEFENDANTS.
- ESTABLISH PRETRIAL SCREENING PANELS TO DETERMINE VALIDITY OF SUITS.
- IMPOSE PENALTIES FOR FILING FRIVOLOUS SUITS.
- ABOLISH/LIMIT PRE-JUDGEMENT INTEREST AWARDS.
- CAP NON-ECONOMIC AND PUNITIVE DAMAGES.
- CAP ATTORNEYS' FEES.
- ABOLISH OR MODIFY THE COLLATERAL SOURCE RULE AND JOINT AND SEVERAL LIABILITY.
- AUTHORIZE STRUCTURED SETTLEMENTS AND ITEMIZED JURY VERDICTS.
- REDEFINE STANDARDS OF CARE.
- REVITALIZE A RESTRICTED FORM OF SOVEREIGN IMMUNITY.
- MODIFY STATUTES OF LIMITATION.
- AUTHORIZE JUDGES ONLY TO DETERMINE DAMAGE AND AWARD AMOUNTS.
- ADOPT COMPARATIVE NEGLIGENCE STANDARDS.
- LIMIT THE DISCOVERY PROCESS.

ATTACHMENT 2 .

National Conference of State Legislatures

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President David E. Nething
Majority Leader
North Dakota Senate

Executive Director
Earl S. Mackey

Summary

Selected State Legislative Action

Re: Affordability and Availability of Liability Insurance

The attached summary represents various actions taken, under consideration or planned for the interim by selected state legislatures. This list highlights legislative activity and some regulatory initiatives. It is not a comprehensive survey of all pending legislation or of future introductions. There are no assurances that legislation indicated as passing both houses will be signed by the governor.

In most instances the information was developed through telephone discussions with legislative research and legal staff in the states.

Michael Bird/Brenda Trolin
March 10, 1986

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ALABAMA

Under Consideration

o House Bills 213-219 comprise a legislative package proposing an array of solutions, including:

  o HB 213 - establish noneconomic damage caps at $250,000; modify the collateral source rule; limit attorneys' contingency fees; and permit structured settlements.

All of the above pertain to medical malpractice.

  o HB 215 - allows introduction into evidence the amount of reimbursed expenses related to a pending civil suit.

  o HB 217 - amends the "scintilla" rule by increasing the minimum standards of proof needed to be met to bring about a tort liability action.

  o HB 218 - would cap liability for punitive damages in civil actions at $100,000.

ARKANSAS

o Not in session in 1986.

o An interim committee reviewing the entire issue has been formed.

o A separate Ways and Means Committee study is reviewing taxation of property/casualty insurers.

CALIFORNIA

Under Consideration

o The Speaker of the House has called for establishment of a state board to review insurance rates and a state fund to provide liability insurance for cities and counties.

o A review of the efficacy of establishing a state reinsurance fund is underway.

Previous Action

o Restricted attorneys' contingency fees, an issue upheld by the U.S. Supreme Court in 1985.

HAWAII

Under Consideration

- o establishing medical malpractice reforms.

- o relieving state and local governments of liability insurance unavailability problems.

- o abolishing joint and several liability.

MINNESOTA

Under Consideration

o In the Senate, legislation is under consideration to:

a) structure settlements.
b) permit the Insurance Commissioner to declare rates excessive and return the amount of excessive premium payments to insureds.
c) authorize nonprofit corporations to form self-insurance trusts.

o SB 1592 would modify the collateral source rule. Disclosure of related damage payments would be made to a judge (not a jury) who in turn could deduct this amount from any final judgment.

o HB 1764, now in the Senate, deals solely with medical malpractice, and proposes to:

a) cap noneconomic damages at $400,000.
b) itemize jury verdicts.
c) abolish punitive damages.
d) authorized periodic payments for settlements exceeding $100,000.

o HB 1776, if enacted, would abolish joint and several liability, cap noneconomic damages at $250,000 and modify the collateral source rule.

Previous Action

o Authorized establishment of a joint underwriting association for dram shop coverage in June, 1985 and for medical malpractice coverage in September, 1985.

NEW JERSEY

Under Consideration

o A legislative package designed to accomplish insurance regulation and tort reform is likely to be introduced in mid-March.

o Senate legislation already introduced would create an excess insurance fund and require all public entities, except the state, to join. All public entities would be indemnified for claims exceeding $500,000.

o Other Senate legislation seeks to provide idemnification of hazardous waste contractors and modify standards of negligence.

o The Assembly Insurance Committee is reviewing the feasibility of having premium increases justified through state claims experience in New Jersey.

Previous Actions

o Counties, municipalities and school boards may self-insure or join together in regional insurance pools.

o The Insurance Commissioner prohibited midterm cancellations and nonrenewals unless notice is given.

NEW MEXICO

1986 Session Completed

o expanded the state's risk management program to include provision of property/casualty liability coverage.

o rejected limits on attorneys' fees.

Study Groups

o establishing a legislative liability insurance study committee.

NEW YORK

Under Consideration

o The Governor has established a Blue Ribbon Commission due to report on March 31, 1986.

o Assembly Bill 8408B would prohibit midterm cancellations and required 60-90 day advance notice of nonrenewals.

o Senate 6769A proposes several tort liability reforms, for municipalities, including:

a) structured settlements.
b) prohibitions on frivolous suits.
c) separate statistical gathering for in-state claims experience.
d) abolition of joint and several liability.

o Establishment of discretionary joint underwriting association authority is a possibility. New York has a voluntary market assistance plan for municipal liability coverage.

o A sixty-day mandatory notice for nonrenewals and premium rate changes is being contemplated.

o The open rating season for property/casualty premiums expires May 15, 1986. There is some discussion of returning to a prior approval system.

NORTH CAROLINA

1986 Special Session Completed

o authorized, on a standby basis, the Insurance Commissioner to establish joint underwriting associations.

o authorized the Insurance Commissioner to extend the state's FAIR plan to all areas of the state.

o called for a referendum on a state radioactive repository site act.

NORTH DAKOTA

o Not in session in 1986. The entire issue, however, is under study.

PENNSYLVANIA

Under Consideration

o Senate Bills 1391-95 have been introduced. Collectively, they propose to accomplish the following:

1) authorize establishment of a joint underwriting association for all lines of unavailable liability coverage.
2) require 60 days notice of insurance premium rate increases.
3) require disclosure of insurance company loss experience within the state.
4) establish a central risk management agency - provide advice to local governments.
5) establish a joint self-insurance fund for municipalities and authorize cities to join.

o The House has completed a comprehensive hearing process, begun last September, which has looked at key problems, major causes and options to resolve the crisis. Reportedly, a comprehensive tort reform package could emerge from this effort.

SOUTH DAKOTA

Session Completed Except

For A March 17, 1986

Session Day

To The Governor

- SB 280 which will require pre-discovery, fact-finding hearings before a judge to prove that there was willful and malicious conduct in order to file for punitive damages.
- SB 282 will cap medical malpractice awards at $1 million.
- HB 1381 would establish self insurance pools for public entities for purposes of securing liability coverage. A gubernatorial veto is possible. This legislation also requires the transfer of $2 million in 1988 from the self-insurance pool to the General Revenue Fund for repayment of start-up costs.

Under Consideration

- SB 216 requires the same $2 million transfer as in HB 1381.
- SB 333 would establish a master state insurance contract and would require injured parties to notify, within 180 days, the appropriate counties and/or municipalities of the incident in which they were harmed or injured.
- There has been mention of a possible special session on liability insurance generally and/or establishment of a political subdivision insurance reserve fund.

TENNESSEE

Under Consideration

- dram shop liability reform is being sought.
- expanding insurance industry regulation generally and strengthening rate regulation specifically is the subject of two bills. The major thrust is to require that rates be based on claims experience in Tennessee.

Previous Actions

- Established a Claims Commission to handle suits against the state.

Interim Activity

o It is anticipated that a legislative interim study on this issue will be authorized.

UTAH

1986 Session Completed

o repealed joint and several liability.

o authorized establishment of market assistance plans and joint underwriting associations.

o limited directors' and officers' liability through revamped standards of care.

o modifications to statutes of limitation, mandatory arbitration and establishment of pretrial screening panels are issues on which we are attempting to get clarification.

VIRGINIA

1986 Session Completed

o. no major action in 1986 session.

o will establish an interim study committee on the entire liability insurance issue.

WEST VIRGINIA

1986 Session Completed

To The Governor

o legislation capping noneconomic damages and pain and suffering awards in medical malpractice settlements passed. The caps were set at $1 million per incident.

Legislation Considered - Not Passed

o bills which would have authorized entities to self insure the establishment of a self-insurance fund for public entities.

o legislation proposing to grant local governments immunity from liability and permit risk management pools among cities and counties.

o legislation which would have prohibited cancellation of policies without adequate notice.

o legislation placing noneconomic damage caps on all tort liability judgments.

Interim Studies

Although not official, an interim study on this issue is possible.

Chairman PICKLE. Thank you, Senator Jones.

We have another vote that has been called on the floor. We are going to try to proceed so that we might receive any answers we might have from you. I ask the members to go as far as we can and then come back if we recess for just a few minutes.

I appreciate the testimony that both of you gentlemen have given because I consider you not only State but national leaders in this field, and I take it from your testimony that you do not feel that there should be Federal regulation or Federal intervention on this matter; is that correct?

Mr. JONES. That is certainly the position of NCSL, Mr. Chairman.

Mr. OLSON. Yes, Mr. Chairman, relative to McCarran-Ferguson or preemption, but I certainly think that you have the authority and the compelling obligation to oversee what we do in the States. The only reason we can regulate in the States is because you have given us that authority through McCarran-Ferguson, but I would submit that yes, sir, that is the case.

Chairman PICKLE. I don't think this committee or any of the members of the committee are recommending or taking any position about Federal control or regulation of the insurance industry, but we are trying to establish a broad-based record here to get as much facts together in one place as we possibly can.

If it is to be a State control matter, what have the States done in view of this present crisis? What have you done at this point to alleviate that condition?

Mr. OLSON. Well, there are 50 States, and I literally yesterday came from the first of this year's quarterly meetings of the National Association of Insurance Commissioners. The States have begun, and Texas is singularly the most regulated State in the United States, and I don't think there would be any contradiction to that. We are a State of about 850 people at the State board of insurance, our insurance commission, with about a $35 million budget.

Our response has been in 1980 we began to treat directly into the rate base, we began to use and take into consideration investment income. There are States that have open rating, and the real contradiction here is that philosophically, we regulate for solvency, but when somebody says why did you let those rates go so low, the response is that, well, in a fairly pure environment like this, nobody wants high rates, everybody wants low rates. In my 7 years as a regulator, this is the first time I have ever heard anybody say why did you let those rates go too low? Generally it is that the rates are excessive.

We have put into place in Texas and are fixing to adopt on an emergency basis a number of provisions such as an increased notice period for cancellations and nonrenewals, the recommendation to the legislature to form an insurance exchange, which would give us in Texas a new reinsurance capacity. Hopefully, we could participate with Florida and New York and Illinois.

But I think the most constructive thing that has happened, and one of the things that we have been discussing in San Francisco the last 4 days, is this cycle and how do you deal with it in the fullness of time? The way you deal with it in the fullness of time, in my judgment, is that you directly take into consideration in those States that have prior approval, investment income, period. You level out those big cash swings. You treat it directly. ISO, we are not a rating bureau. We don't use their numbers. We collect our own data in Texas, and that is why we have such a large department.

Chairman PICKLE. You enumerated some of the things that Texas is doing to try and straighten out or give relief in this area. Are the problems that Texas is experiencing the same in all the States?

Mr. OLSON. Yes, sir.

Chairman PICKLE. You do not want expanded Federal regulation, but you say there are certain things we can do. I know, Senator Jones, you said in your testimony that you do not want regulation, except in those areas where there is already Federal jurisdiction, for example the environment. In those areas, are you stating that we should go forward with whatever action we think necessary?

Mr. JONES. Mr. Chairman, I think the Congress would do very well to look at some of the exposures that have been created through environmental liability to determine if, in effect, the mandate you have given or the opportunity you have given claimants is commensurate with the actual damages which are concerned.

I think we need to look at the question of insurance ratemaking. Insurance ratemaking is completely different. In most products, you can determine what your cost of the product is going to be and then price accordingly to cover your costs. In insurance, you are, in effect, looking behind to see what has happened in the past and trying to predict what will happen in the future. So you don't know what the price of your product is until the policy year has terminated.

So that where you have a situation where new circumstances are presenting themselves, where a company has no lead time to anticipate a new concept or a new theory of liability will prevail, there is no way that you can have the predictability necessary to tell what the premium should be.

When you are in a time of change in your tort system, literally it is impossible, and particularly with some of your so-called long tail exposures, to know your total liability for years.

Chairman PICKLE. How would either one of you respond as to what has caused our difficulty today? Is it a question of reinsurance, Commissioner Olson, as you have indicated, or is it in the rates of the premium versus the investment aspect?

Mr. OLSON. I think it is very simple, Mr. Chairman, and please forgive me for simplifying something that is immensely complex, but the general public, I think, can't deal with that complexity and it is tough to communicate it. For cycles, we are in the eighth cycle in the insurance industry, and cycles generally go, there are arguments, from 3 to 4 years, 6 to 7 years.

In 1975–76, we saw the medical malpractice problem and we saw a little bit of the products liability problem. We are now seeing a 10-year cycle exacerbated by 15-, 20-percent interest rates. Interest income was high. The industry literally went after any risk it could take, cut rates, and in cutting rates gave the business away, interest rates came down, investment income couldn't offset the claims that came in, and essentially what happened was that the rates were inadequate. They competed themselves into the ground and they are trying to get back in 1 or 2 years what they did to themselves in 10 years. It is that simple.

Chairman PICKLE. I notice in your statement that you said that help is on the way.

Mr. OLSON. Yes, sir.

Chairman PICKLE. That is, you list specifically some signs of improvement. The industry has raised $5 billion in new capital. Higher rates are being implemented. They are rethinking their priorities and they are placing the business of insurance ahead of investment.

Are those the type of things through which you think we will be able to again get adequate control so that we won't have a further crisis? Will the States come back and be able to control the matters adequately?

Mr. OLSON. In my judgment, yes, sir.

Chairman PICKLE. One year, 2 years?

Mr. OLSON. Anywhere from 6 months to 2 years. In some lines I am not sure the coverage will be available.

Chairman PICKLE. In Texas today, can any company get adequate pollution insurance?

Mr. OLSON. No, sir.

Chairman PICKLE. Asbestos insurance?

Mr. OLSON. No, sir. And I'm not sure we will ever be able to do that again because I'm not real sure that the international marketplace—our technology in this country is so immense that when you take out an insurance contract, you are buying a promise to be delivered in the future. Our technology is so immense that the predictability of that risk is exponential for underwriters.

Chairman PICKLE. Let me ask you two gentlemen—the time is running and we must go to the floor to vote—can you stay with us a little longer? We have two other panels and I want to get to them quickly.

I am going to suggest that we have a recess for 20 minutes, and then we will finish this panel and go to the others. That will give us all a chance to take a little break. I am going to declare a recess for 20 minutes, and then we will resume.

Thank you for your cooperation.

[Recess.]

Chairman PICKLE. The subcommittee will come to order.

We will resume our sitting.

I appreciate the cooperation of you two gentlemen, because I know you are anxious to get back.

Mr. JONES. Lyndon and I served in the House of Representatives briefly together, and then I served in the legislature, I'm in my 22d year, so we understand your problems.

Chairman PICKLE. Well, I'm glad you do.

I want to make one additional comment, and then we will go to the members.

You recommend against Federal regulation and I certainly don't recommend that, we don't want to go that route. And yet what has happened over the last 2 or 3 years, whether it's the premiums going down or more competition, we have gotten into a "national crisis" here. Now what can we expect? If I understand the situation now, you can't get pollution insurance, you can't get asbestos insurance. Where will people go if they want coverage of that sort? What is their relief? Where do they get some insurance? How can they stay in business? Do we just say, well, that's out of reach? Mr. Olson, you said such insurance probably is not going to be available any more.

Mr. JONES. Mr. Chairman, there are a number of areas, for instance, on long haul trucks where you have set a, I believe, $5 million figure. It's extremely difficult for particularly small truck operators to find coverage in that amount. You might do well to look at that mandate to see if a more realistic figure would cover most of the potential exposure.

We in NCSL have previously shared with this subcommittee various reports on the subject, as well as a display of State legislation either enacted or under consideration, which was attached to my testimony, and yet we have other reports. I've got a report here, State-Federal issue briefs, that I would like to leave with the committee, that outlines what is being done in the various States.

Keep in mind, when you talk about—well, I understand there are those who are discussing a change in the McCarran-Ferguson Act. Keep in mind, no one company has enough exposure in various lines that they can have a creditable pool of statistics on their own experience, and that is the major reason you have to have rating organizations that assemble the information from the various companies, so that they will have a better idea of what is happening.

If you have an inadequate pool of experience, your rates are not credible at all. I think a major factor that is impacting insurance availability and affordability today is that question of predictability, because with new concepts of liability being brought forward that were not contemplated in the experience base on which rates were made, then you get again the question of can we rely on whether the rates we are charging are adequate?

Keep in mind, most people don't realize in the history of insurance the concept of regulation was not as a consumer protection vehicle, but came about because of the insolvency of a large number of companies. The States realized that if insurance was sold as a promise to perform in the future, and if they allowed the companies to engage in practices that would not guarantee the solvency of those companies when the time to perform that promise came, there's nothing to give.

So basically solvency of the company is the basic thrust of most of the insurance regulation in the country.

Chairman PICKLE. Well, I'm not going to dwell on this part. I recognize that it may have started originally as a matter of solvency or insolvency.

Mr. JONES. Well, it's becoming a problem because you have got a number of—probably a higher number of insolvencies across the country now than you have had in any 5-year period since the early 1930's.

Chairman PICKLE. Are you saying then that if we get into any area of insurance where to take that step would mean an insolvency, you just don't write the insurance? So that means there would be no insurance available in some fields if a company is threatened with insolvency?

Mr. JONES. We made the statement earlier, that it's extremely difficult to have predictability in the area of pollution control, as an example, because it's a new field of law. It's one that is still evolving, and until that body of law becomes very well standardized, it's going to be difficult to get people willing to expose themselves at a given rate today for something that may happen tomorrow.

Mr. OLSON. Mr. Chairman? Forgive me. If I may give you a very constructive suggestion as to what we are doing at the State level.

There is a tendency right now—and I understand it politically and I understand it as a payer for commercial exposures. I pay about—I counted up the other day, I've got nine different premiums I pay for commercial insurance. Directors and officers liability. On and on and on and on.

We are beginning to attempt to shock the system with a bandaid response. I think—in the Congress' risk retention, for instance, which I think is an immensely dangerous—I think risk retention is going to make ERISA pale in terms of the abuse that potentially will come about. I don't want to get into all that. I'll get into it how ever much anybody wants to, but risk retention has been one response.

The other response is something the insurers want, but I think practically what we are going to end up dealing with is regulators, and that is once we get beyond all the conversation, what do you do to encourage predictability in the system through the contract?

Because, understand, you're buying a contract, a promise in the future. We are now in an occurrence, we pay an occurrence made policy in most lines of general liability. And within the bowels of most insurance departments today we are now seeing insurance regulators being and looking and assessing a claims-made policy.

Take asbestos and silicosis, for instance. You have asked the manufacturer, or the insurer is suing the—the injured claimant is suing for things, occurrences that happened 10, 15, 20, 30 years ago, that we didn't even know technologically. There may have been negligence—I'm talking in the aggregate, not in the individual instances.

The new claims-made approach Texas hasn't adopted. We haven't adopted it because we think that there are going to be a lot of insureds out there that when this market begins to turn around and come back, that we want to make sure that we didn't adopt—we were told by the industry, if you don't adopt the claims-made policy, there's not going to be any coverage.

Well, the fact of the matter is that I'm not sure I believe that. I think I believe that in certain lines of insurance.

What a claims-made policy does is establish a benchmark and says if you don't notify the insurer during the contract year of the injury or the potential injury or harm, then you have no coverage unless you want to buy what they call a tail coverage. As opposed to an insurer being on a risk for 500 years out in time. And it's a very complicated, very technical response, but it is a policy-approval response that every department can deal with.

In Texas we haven't adopted a claims-made policy yet. We have it in some lines of insurance. Because we don't want to overreact to the cycle. We don't want the insurers to say to us, if you don't adopt it, we're going to shut it off, because it takes away some coverages that the insured would have that they ordinarily might not have.

So that's one very real response.

The other one is market assistance programs that have been very helpful, and that is if insureds—especially your constituents, Mr. Chairman, have called us, and Texas insureds—can't find coverage, and we have a voluntary mechanism whereby we attempt to assist. And I think most States now have those market assistance programs.

But we are all in a reactive mode to do something. The Federal reinsurance, for instance. I made a statement—Mr. Hunter is my friend and Mr. Hunter, he's just misguided about some things—and we agree on some things, but Mr. Hunter made the statement and Mr. Nader made the statement we need a Federal reinsurance program.

My response to that was, if you like the Federal deficit, you're going to love a Federal reinsurance program. Because your exposure is exponential. You have no way to judge what it will do to the credit of the Treasury.

So I merely make those statements as being some constructive things that we are doing where we won't see the benefit of them for about 1 year. But markets will change, prices are easing up. We are not going to give to the insurers in 1 or 2 years what they need because of what they did to themselves in 10 years. It's just not responsible.

And the other question is a little more philosophical, and that is the spreading of risk.

Chairman PICKLE. Thank you, Mr. Olson.

Mr. JONES. Mr. Chairman, you have heard the statement many times that the insurance business is cyclical. You have heard the expression that to some of us is relatively new, the investment income underwriting. That's not new. In the late 1920's, the insurance industry went through the same type of program where they were ignoring normal underwriting standards in order to have the opportunity of investing the premiums.

So it's a cyclical thing. I think over a period of time this cycle will work out, once our tort system begins to settle down a bit, so that you can have hopefully a higher degree of predictability.

Chairman PICKLE. Let me recognize our colleague, Mr. Schulze, and then we'll come back to comments.

Mr. SCHULZE. Thank you, Mr. Chairman.

Both of you have had a fair amount of experience in this area, and I presume from time to time have worked with the Federal Government coordinating activities relating to the insurance industry.

My question is, do you think there should be better communication, more coordination between the Federal and State levels in the insurance industry?

Mr. OLSON. Yes, sir, I certainly do.

Mr. SCHULZE. How would you do that?

Mr. OLSON. Well, I guess maybe at the State level—and I thank you for asking that question, because especially when we're dealing in the last 2 or 3 years with financial integration, the financial supermarkets, banks, savings and loans—Senator Jones and I come from sort of rural areas, and there are sayings that "good fences make good neighbors." "Sheep and goats versus cattle." We found that during financial integration discussions that we felt like, as insurance regulators at the State level, we knew more about banking and savings and loans than savings and loans and banking folks; they had no idea what we did and didn't care. Yet that major fiber of commerce they wanted to merge into, they knew nothing about that. They knew nothing about the risk taking. And these kinds of hearings are very, very helpful to us as State regulators. Because when there's not a problem here, when your constituents aren't clamoring, when you are having to deal with 5 billion problems, we don't have any real forum where we need to talk, where we need to communicate.

But at the State level, because we aren't at the Federal level, we often don't get to peddle our wares, show our trades. You don't get to see the stock analysts and the securities analysts. You hear the political demagoguery of irresponsibility, underfinanced departments. You don't hear or see or feel or get past the smell test for what are those guys really like. Do they eat at the trough of the insurance industry? Do they go through the revolving door? You don't hear the cerebral interaction. And I think it is immensely healthy, and I think that whether it be in the area of securities, where we value securities, whether it be in the area of banking, savings and loans, financial institution, commerce, tax, for instance, in the area of discounting of reserves. We've got four CPA's that didn't come out of the insurance industry—they're insurance regulators—that know more about the discounting of reserves than probably most insurance executives. And it will take you up one side and down the other.

They will say to you, "We know you have got to pass a tax bill," or the reform act going on. "We know that. And we know you've got problems, that nobody goes to bed and gets hot and bothered about discounting reserves."

But as regulators, in our microscopic view, we'd say we're extremely angry today. I'm going to tell you right now, before this subcommittee, publicly, on the record, representing the National Association of Insurance Commissioners, we are extremely angry at the insurance industry and special companies relative to their discounting of reserves.

Now you have a different kettle of fish to fry, because you are looking at a bigger picture as to how to generate income. Our proper response is I, as a regulator—we, as regulators, are interested in one thing, and that's solvency. And when you begin to mess with their reserves, when you begin—and they're underreserved, then that causes us solvency problems.

On the other hand, you've got tax consequences. So there are those kinds of dialogs, if you can hear us and we can understand where you are, it is just very, very constructive.

Chairman PICKLE. Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

I thank you both for your splendid testimony, and I am going to ask you whether or not there is any evidence that there are higher premiums being charged one segment of the industry in order to compensate for losses in another industry? In other words, are these industry sectors in pigeon holes or is there a great deal of moving around of money where there are profitable and unprofitable lines and they intermix, where the higher ones pay for the lesser ones?

Mr. **Jones**. I would like to make one response there, that impinges on the insurance industry as a whole. You have heard questions of availability. Every State has limitations as to the volume of business an insurance company can write in relation to its capital structure. One of the problems we are having now is the losses that we have seen in recent years as the investment income eroded has had the effect of reducing the total capital structure.

Another factor that I have not heard discussed today is several years ago a number of noninsurance operators, entrepreneurs bought some of your major insurance companies because they felt they were over capitalized and, in effect, drained a good bit of the capital out from under the insurance industry, to use in other parts of their conglomerate business.

I do think that you might do well to look at the acquisition of an insurance company to see what the purchasers plans are, in reference to the capital structure of that company. Because one of the problems in availability right now is capital structure, part of it from the losses that were taken as a result of writing risks at an inadequate rate when the investment income fell out from under them and still having those policies, that keep losses coming in.

Mr. **Guarini**. In my limited time—I have a very short space of time—let me ask, does the reinsurance problem that we have exacerbate the whole crisis before us?

Mr. **Jones**. It is a major part of it. I mentioned that to the subcommittee.

Mr. **Guarini**. A lot of this is offshore. Now, should there be some Federal regulation or criteria where the States would be ineffective in handling a situation like that, in order to safeguard the American public?

Mr. **Olson**. In my judgment, the driving—if you assume that the interest rates, when coming down, loss of investment income began, this problem of pricing inadequacy. The driving force behind this crisis today—and make no mistake about it, regardless of what anybody says, there is nothing phony about what is going on today. In 1982 there were——

Mr. **Guarini**. Is there a bigger crisis in reinsurance than there is in insurance?

Mr. **Olson**. I hope not, but that is what we, as regulators——

Mr. **Guarini**. Do you believe it?

Mr. **Olson**. What we as regulators are trying to find out——

Mr. **Guarini**. So if most of this is overseas, in Lloyd's of London and the Arabs and the sheiks and the big families are splitting it with Lloyd's of London, as your chart shows, should not the American Government take some course of action to see to it that the public is protected?

Mr. OLSON. In the discussions that I think the Trade Representative has been having, and other, the GATT meetings, there have been efforts to deal and look at reinsurance for the first time because it is international in nature.

Mr. GUARINI. But that is 10 years down the road. Before they finish this GATT round, you and I will have a lot of age and a lot of wrinkles on us.

Mr. OLSON. Smarter people than I have suggestions. I think it is the driving—singularly the driving force behind this construction because there is a lack of capacity. And Lloyd's of London is simply saying—and every other reinsurer around the world, Japan—Lloyd's of London has just moved about 7 percent of our capacity in the United States to Tokyo, to Japan. They said we do not want a "made in America" label on your business. We are going to Japan where the premiums are lower but the exposure is not as high.

It is not a matter of blackmail with these people. They are just saying look, we are going where we can make a buck.

Mr. GUARINI. If we look at the reinsurance business, the volume that is done in the world today, what part of the American reinsurance business is overseas?

Mr. OLSON. I would say around 67 percent. Thirteen billion dollars in premiums is paid for reinsurers, in reinsurance premiums.

Mr. GUARINI. Now suppose there is a breakdown in that insurance overseas. Then our American industry would not be adequately protected, unless there was some safeguard that was put in place?

Mr. OLSON. That is correct.

Mr. GUARINI. Do you have anything to recommend to this committee?

Mr. OLSON. I would say the only thing you could do would be to establish some sort of minimum capitalization criteria. Mention was made earlier of the risk retention provisions in reference to public liability. Some of those captive companies that were formed were formed overseas by people that were not in the insurance business.

Mr. GUARINI. Well, that is something different. We are talking about——

Mr. OLSON. No, it is not either. Because some of those people went into the reinsurance business.

Mr. GUARINI. But there are two kinds of offshore business, as I understand it. One is the reinsurance. And the other is where certain sectors, like the trucking industry or whatever it is are captive and go to Bermuda and——

Mr. OLSON. Some of the captives undertook to go into the reinsurance business.

Mr. GUARINI. That could be so, too.

But what I am asking is, do you, Mr. Olson, have any recommendations that would be helpful to our committee in providing the adequate protection we should have for our industry and for our people here in America, where two-thirds of all the insurance that is written is written outside the continental limits of the United States?

Mr. OLSON. My response is merely I think we are talking about the issue of collectability and that is when the Aetna or someone like I use goes out to get the money to come back to pay the claimants that it is going to be there. What we, as State regulators, have done within the last year or year and a half—well, actually, the last 2½ years, we have grappled with this problem because in 1982 we began to see this crisis emerging in 1982 internationally.

I traced a reinsurance fraud with the Superintendent of Insurance in New York and the U.S. Justice Department from London to Istanbul to Rumania. And what we began to see was that we had 17 companies in the United States that had $400 million in exposure in one transaction. And seven hospitals in the city of New York, not for profit, that thought they had insurance. They had the gold leaf paper. They had been sold all these deals. It was very similar to self-insurance, very similar to risk retention. It was the greatest deal in town. It was cheap.

And what happened was we began to unravel, with the Justice Department, this fraud. And when we went to the Rumanian owned company—a Communist owned company—ADAS, in the courts, ADAS said we have none of your exposure because in that reinsurance transaction there were about 12 reinsurers that laid off the risk.

So what did we do as regulators? We saw products liability fraud in 1982 like the school of fish. These bird dogs are highly sophisticated folks. The ones that are making money in the insurance business today are the crooks. And they get into the area of self-insurance, risk retention. I am telling you they are going to be out there. They are out there, giving this stuff away. It is too good to be true.

What we did was, one simple thing. We said—we went back to the insurers and said you, as an insurer, in order to get credit in your annual statement for your reinsurance, that risk—that liability on the asset/liability side—in order to get credit on your annual statement for the reinsurance that you ceded, the liability that you divested yourself of, you had to—that reinsurer had to place letters of credit in a Federal Reserve System bank in the United States for a period of time. Lloyd's of London such as trusteed accounts.

In the event that there is a collectability problem, it is essentially an escrowed account. And what that has triggered is much more discipline in that reinsurance market.

Mr. Guarini. If that is so, though, if the insurance company has the ability to get the credit, then that would work out as the solution. But if the insurance company is not heavy enough and cannot cover by letters of credit than that big fraud, the $400 million would be fully perpetrated.

Now I am just wondering whether or not we, as a federal government, can help you as the Commissioners of Insurance on the State level, to try to mitigate this problem that exists?

Mr. Olson. I do not know, except through your treaty powers. I just honestly do not know, and much brighter people than I probably can give you a much more informed judgment on that. I have dealt with it for 6 years and my frank response to you is that given the nature of the reinsurance business, it is the freest fiber of commerce I have ever seen in my life. And they very simply—those international reinsurers very simply say—and I am in touch with six of them every 2 weeks around the world. I have got them plant-ed to find out what is going on. Where are we going to be a year from now? What markets are opening up?

And frankly, their attitude is that there are markets other than the United States where they can make money and it is a very laissez-faire business. But I think, except through our treaty arrangements, I am not sure what real meaningful authority or effort we could put into this to regulate that industry.

And I am not sure if it is desireable, frankly. It might be a disincentive to capacity—I think it probably would, to some degree—to capacity. It is sort of like the provision of the excise tax you are dealing with right now. You have heard arguments in raising the excise tax from 1 percent to say 3 or 4 percent or whatever. From a regulatory side, I would say well, there is obviously some reinsurer that does not want to get hit with a higher excise tax. But from a regulatory standpoint I would tell you that it is probably a disincentive to more capacity.

Mr. GUARINI. Do they have an FDIC?

Chairman PICKLE. The Chair recognizes Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Olson, earlier in the day we had a witness, Mr. Jones, representing the insurance industry. And he was asked if there were any problems that the industry itself would admit that they were at fault. And when pressed, finally he said no. But in your testimony, you outlined several actions that the States are taking that makes it appear that those actions were taken to try to correct some fault.

One that you mention on page 7 was the interim cancellation of contracts. Were these actions taken because there was a problem and there was perceived to be a fault on the part of the insurance industry and harm being done to businesses in general? Was there reason for a State corrective action?

Mr. OLSON. Let me give you a real personal example about how bad this is.

I have a homeowner's policy. I am living in a townhouse. I am from Waco, TX. I reside in Waco and I stay in Austin. And I have a homeowner's policy.

And about 6 months into the contract, I had paid my homeowner's policy, and I was—under the law I am entitled to 10 days notice of cancellation or a change in hazard.

My homeowner's policy was canceled last year, midterm, and my rates were raised 40 percent. We formed a homeowner's committee of one, me. I filed a complaint with the State board of insurance and decided I would investigate and/or examine, with my examiners, that particular company's market conduct.

Frankly, what happened was the change in hazard was not mine or my townhouse association. The change in hazard was that they underpriced the product and they got caught in the tight. And so they just midterm cancelled. The change in hazard was not some wiring somewhere. The change——

Mr. ANTHONY. So what you are—if I may interrupt—what you are telling me is that there was fault in the industry and a regulator stepped in and tried to correct it?

Mr. OLSON. That is right, but only—midterm cancellations have only occurred with a few folks. Mr. Jones and I would disagree to this extent.

I am telling you, unequivocally, that the insurance industry acted irresponsibly, they were undisciplined. The beneficiary of their lack of discipline and their lack of responsibility, was the consuming, buying public for 6 to 7 years. But nobody cares. You know, what you done for me lately? And nobody cares about yesterday. They are looking to tomorrow.

Mr. ANTHONY. You have me right where I want to be and that is tomorrow. You have been asked this question, but you have not answered it to my satisfaction. The industry has been asked this question and they certainly have not answered it to my satisfaction. And that is, will the industry, has the industry, or can the industry get into predatory pricing, lose huge sums of money and then shift the cost to the most stable lines of business that they actually can predict, raise the rates about 1 or 2 percent, suck that huge volume of money off homeowners, automobiles, to take care of their other risk lines that they have either under-priced or, as Mr. Guarini said earlier, just wrote a bunch of garbage insurance, trying to capture every premium dollar that they could.

Now the insurance people say no. My question to you, as a State insurance commissioner and I assume representing the other States, do you have the regulatory capacity to ensure that that does not occur, is not occurring and will not occur?

Mr. OLSON. We try like hell to do that. They cannot transfer by line in Texas. I cannot speak for other States. Right now the insurance industry, when they make a filing in Texas, and you understand we do not have anything to do with ISO or anybody else. We gather our own data.

We have a highly sophisticated rating structure. And we set rates by line of insurance.

For instance, if you made a great amount of investment income in a certain line of insurance, general liability, professional liability, medical malpractice, each line of insurance, surety, bond—each line of insurance is going to be looked at by line and a profit loading, a profit and contingency—in the equation is going to be established.

Let me tell you what is happening right now. Commercial automobile liability insurance, the industry wants to tell you that a 5-percent profit and contingency is what they have got to have to have an adequate return on net worth or on their assets. In Texas, while I have some problems with using it philosophically because I think you need a little fudge factor regulatorily—I really do, in setting rates.

In Texas, we have negative profit loadings today for these long tail lines of insurance. Basically saying, you made so much in investment income that you have got to take a hit, a negative hit. We do it by line in Texas.

And all I can tell you is that we are in a situation now where everyone is saying why did you let those rates go so low because you are having to raise them so high?

Mr. ANTHONY. That is a good question. Why did you?

Mr. OLSON. Mr. Anthony, for the last 7 or 8 years, I have spent my time before the legislature—not Senator Jones necessarily—answering to constituents and to my Governor and to my Lieutenant Governor and my speaker, why are those insurance rates so high?

You tell your constituency and I will tell my constituency I am against lower rates. And therein, as a regulator, I have a responsibility to interpret that.

Mr. ANTHONY. If you are a regulator and if you are going to do a good job, and if you think that they were doing, as you just got through saying, by God you should have told the public they needed higher premiums.

Mr. OLSON. We did it in Texas. In fact, what we did in Texas was we put a floor—you put Mr. Hunter—and I appreciate the compliment.

You heard Mr. Hunter say that Texas broke the cycle. And frankly, in our rating system in Texas, we came in and commercial homeowners—they were giving the business away, probably 90 percent off the rate we set.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. OLSON. And I came in and put a floor in the rate and said you cannot go any lower.

Chairman PICKLE. What did you do when you broke the cycle?

Mr. OLSON. Essentially, we said—we set a maximum rate, Mr. Chairman, in Texas for commercial homeowners. The pricing was so fierce in what we call the Lloyd's that we began to feel that we would not approve a deviation off the maximum rate reset more than 45 to 50 percent.

When we began to see the pricing so fierce, our board came in, Mr. Thornbury and I, and essentially put a floor and said you, the insurers, may not go below or charge a rate below this certain amount. And we essentially interrupted the normal fiber of commerce there.

That can be done in a prior approval State, but in a State that is wide open, let us say California or Illinois, the competitive cycle continues. And frankly, a lot of people were upset that we would not allow the rates to go lower.

Chairman PICKLE. I want to thank both of you gentlemen. I wish we had much more time, because we have a lot of questions we would like to ask. But we do have two additional panels, and we must continue because they have been very patient.

Before you go, Mr. Olson, I want to try to reconcile something in my mind. I like the aggressive spirit that you indicate the Texas Commission is maintaining. And I am encouraged that you state that given another 6 months or a year we will be around the corner and we will be in much better shape, and indicating that perhaps this crisis can be mitigated.

At the same time, some groups cannot find insurance. Others, particularly in the malpractice area, cannot afford it, and damage awards are so high that they are pushing everything up. In my own State, you indicate that there are 75 companies that are on the verge of insolvency; that there are 200 more life and casualty companies that are under severe investigation now as to solvency; and that well over 300 to 400 companies are what you call borderline.

Now that does not sound to me like help is on the way, that you are going to find some relief.

Do you think those companies are going to be able to make it, say, within the next 12-month period?

Mr. OLSON. I hope so, Mr. Chairman. We have—to show you how fast this thing happened, in 1982 we had 7 insolvencies; 1983 in Texas, we had 12; in 1984, we had 18; in 1985, we had 81. It turned that quickly. There are 300 that are under investigation presently by the National Association of Insurance Commissioners, and of those 75 you were just referring to, they are presently in receivership.

One company—by the way, only seven of them are Texas companies. Of the 81 I was mentioning to you, there are only 7 in Texas.

But one thing I might point out, we just had a company—it's referred to as Mission Insurance—it's a $1 billion exposure to the insurance industry from the guarantee funds. And Baldwin United was a $5 billion insolvency. And State regulation has worked that out.

As of Sunday, that $1 billion insolvency—and we didn't come to the Federal Government for help—that $1 billion insolvency of Mission, which has some 35 or 40 companies—it's a reinsurer—we think we've worked that out. At least we hope we have.

The financial services industry, you know—banks, with deregulation, there is some lack of discipline through credit administration. The insurance industry, through its underwriting or lack of underwriting. The financial services industry is going through some really tough changes today, and as regulators, you just have to be judicious.

Chairman PICKLE. Commissioner, you were using a phrase earlier, saying you were unhappy with the insurance companies, presumably in Texas, because of their abuse of what's called discounting the reserves. Is that the phrase you used?

Mr. OLSON. Yes, sir.

Chairman PICKLE. I don't want to prolong this, but can you tell me what you mean by that? I don't quite follow you, and why would you be unhappy with what they've done with that?

Mr. OLSON. Well, basically, when you establish a reserve in an insurance company, the reserve is established for regulatory protection because one will estimate what their losses are going to be in the future. For instance, if you're a doctor, we know from closed claim studies that the average tail or the potential time of exposure from the time the sponge was sewed up into someone until the check is cut by the insurance company is 5 years, 4 to 6 years, 5 years.

The insurance industry reserves for that claim—let's say it's $100,000—they set aside a reserve. My concern is that there are insurers today who are woefully, inadequately reserved. And from a solvency standpoint, therein lies the problem. And with the discounting of reserves——

Mr. JONES. Underestimating reserves.

Mr. OLSON. Underestimating their reserves. But with the discounting of reserves—for your tax purposes, when you establish a reserve, you take away income at the Federal level. At the State level—and this is even more reason for us to be talking about this—at the State level, as a regulator, it's almost antithetical, because we encourage adequate reserves. We encourage adequate reserves to make sure that if the company gets into financial trouble, that the money will be there to deliver on that promise that was paid in the future.

The reason I said I was angry—and not just myself; I'm really not given to hyperbole, and I'm not that—as a regulator, I think it was irresponsible for the insurance industry—I know that politically they did it for certain reasons—to come in, and we have imposed changes in the tax code, in the tax reform bill, relative to the discounting of reserves—but the industry all of a sudden decided that on the one hand they didn't mind cutting loose those discounting of reserves for whatever political reasons and whatever unity was brought about.

But as a regulator, I have problems because I know how shaky the industry is today, and I hope that there is no further incentive from a solvency standpoint to jeopardize those companies.

But you all are much wiser men than I am in putting this package together and have to deal with competing interests that are much grander than my special interest as a regulator, and I respect that, and I understand that, and I've been where you are.

Chairman PICKLE. Well, I thank you very much.

Mr. JONES. Mr. Chairman, may I make one further statement in reference to your tax policy?

Chairman PICKLE. All right, sir.

Mr. JONES. The Texas gulf coast is subject to hurricanes. They don't occur annually. They occur in 5, 8-year cycles. You would do well to look at some way to allow those companies writing business along the gulf coast to retain reserves without taxation for a period of time to allow them to build up a little bit each year to meet that hurricane loss when it does occur, because again it's an extremely unpredictable rate, and if we had some way of getting ready for that hurricane, it would sure cut down a lot of the pressure that does occur when they happen.

Chairman PICKLE. Well, I appreciate that suggestion, and I thank both of you very much. You've been very helpful to us. Thank you.

Now the next panel consists of Mr. John Motley, Mr. David Stanton, and Ms. Betty Wilson.

Mr. SCHULZE. Mr. Chairman, if I may, I'd like to welcome David Stanton, who is a constituent of mine and manager of a small manufacturing concern near West Chester, PA. We're proud and pleased to have you down here today, Dave. I'm only sorry that it has to be under these circumstances.

Mr. STANTON. Thank you.

Mr. GUARINI. Mr. Chairman, I would also like to welcome Betty Wilson, who is a very outstanding citizen of the State of New Jersey. It's good to see you here today, Betty.

Ms. WILSON. Thank you, Congressman. It's nice to see you, too.

Mr. GUARINI. Thank you.

Chairman PICKLE. Mr. Motley is the director of Federal relations for the National Federation of Independent Business. We all know Mr. Motley. I'm glad to see him again.

Mr. Stanton is manager of adminstration of the Lenape——

Mr. **Schulze**. It's an Indian name, Mr. Chairman. The Lenai Lenape Indians were the original settlers of the Delaware Valley.

Chairman **Pickle**. I'm pleased to know that.

And Betty Wilson is president of the Center for Non-Profit Corporations of New Jersey.

Mr. Motley, if you will proceed with your testimony.

STATEMENT OF JOHN J. MOTLEY III, DIRECTOR OF FEDERAL LEGISLATION, GOVERNMENT RELATIONS AND RESEARCH OFFICE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. **Motley**. Thank you, Mr. Chairman.

First of all, I would like to commend you and the committee for holding these hearings and also thank you on behalf of NFIB and it's 550,000 members coast to coast for the opportunity to testify here today.

I would like to submit my prepared statement for the record and to summarize it, if I can.

Rather than add to the long list of horror stories and examples that you have received already about the insurance problems in the small business community, I would like to share with you a couple of examples of the reaction of the small business communities across this country to the crisis that they are facing.

First of all, I should point out that the crisis appears to us to be extremely broad-based. It cuts across almost all lines of small business. We have virtually heard from every type of member that NFIB represents, and we represent members in every SIC code.

In late 1985, NFIB held a forum on tax reform in Los Angeles with the Vice President of the United States. The discussion of tax reform was received fairly well, but when they got into the question-and-answer period, the only thing that the small business people wanted to talk about was insurance problems. The Vice President asked for a show of hands, and it was almost unanimous that that was the No. 1 problem facing these small businesses at that time.

Early in 1986, NFIB held a series of town meetings across the country with various State insurance commissioners, and the reaction of the members who attended was so negative and so hostile that, in two instances, the insurance commissioners were actually forced to leave the room.

In the 40 State White House Conferences that have been held so far, recommendations to do something about the insurance crisis, either to reform the tort laws or to do something else that would help out the small businesses have been the No. 1 or No. 2 recommendation.

And last—this year NFIB repeated its 1984 study of the problems and priorities in small business, in which we asked about 10,000 of our members to categorize what were their most important problems. We gave them 75 choices, the cost of liability insurance came out No. 2, preceded only by the cost of health insurance. Thirty-eight percent of the respondents listed it as their most critical problem. That was the highest listing or rating by the members responding.

In reviewing what is happening out there—and I might say that we've gone to some lengths to try and talk to all different sides of this proposal—we held our own internal, several days of seminars with the insurance industry, with Mr. Hunter, with representatives of all the different facets of the problem, and we have come to the conclusion that there are really three causes for this problem in varying, different degrees.

One, we have a tort system of the civil justice system which we believe is out of control. The expansion of the definition of liability, the huge awards that have been made recently, and the greater amount of litigation which has been filed all point to a system which is out of control.

No. 2, we believe there have been extremely poor insurance industry business practices, and these were just detailed here a few minutes ago, and I don't necessarily have to go into them.

No. 3, we also see a patchwork quilt of haphazard State regulation of the insurance industry. This patchwork quilt allows the insurance industry, in effect, to play one State off against the other when those States try to regulate the industry within its borders.

Solutions to the problem: NFIB sees two broad general areas of solutions.

One is comprehensive civil justice or tort reform at both the State and Federal levels. In our mandate—and most of you probably know that we poll our members every 6 or 8 weeks on public policy questions—in February 1986, we polled them on comprehensive civil justice reform and 86 percent responded positively.

This month, we are polling them on capping awards for punitive damages, and of the first 31,000 responses, 76 percent of the respondents were in favor of capping awards.

NFIB members have been traditionally States' rights oriented. They have never favored a national product liability law until just the end of last year. In December 1981, only 37 percent favored a national law, while 48 percent opposed. In July 1982, 45 percent favored it, 48 percent opposed; and finally in December of last year, 67 percent of the membership favored a national law, and 27 percent opposed.

I believe that this is indicative of the shift that has taken place across the business community to throw some light on the need for action, particularly at the product liability level.

Mr. Chairman, I would also like to submit to the committee in addition to my testimony a compilation of State ballots in which NFIB has polled various different questions such as capping punitive damage awards, pain and suffering awards, contingency fees, and a whole series of questions related to the insurance crisis at the State level.

The second that I believe, or we believe, needs to be taken a look at is a review of the Federal laws that govern the operation of the insurance industry. We think that there are very legitimate questions that need to be raised today, such as is the McCarran-Ferguson Act still justified, the act that exempts the insurance industry from the antitrust laws? Should the FTC continue to be prohibited from taking a look at the industry? And should we finally take a look at whether there should not be minimum standards, minimum Federal standards, for the State regulation of insurance, so that it is impossible for various different insurance companies to play off one group of State regulators against the other?

Thank you, Mr. Chairman. I will try to answer any questions that you might have.

[The prepared statement and attachments follow:]

NFIB® National Federation
of Independent Business
The Guardian of Small Business®

STATEMENT OF

JOHN J. MOTLEY III

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: House Ways and Means Committee, Subcommittee on Oversight
Subject: Insurance Availability and Affordability
Date: March 13, 1986

The National Federation of Independent Business (NFIB) represents over 500,000 small and independent businesses nationwide in all sectors of commerce. On a scale with their response to the divestiture of AT&T, NFIB members have universally expressed confusion and apprehension over another service component of business operations: commercial liability insurance.

For the past six months we have been contacted regularly by members complaining about insurance unaffordability and, in some cases, unavailability:

--A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. Last year he paid $900 for $2 million in coverage. This year he is paying $3,625 for $1 million in coverage.

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--A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. This year they have been quoted a premium of $38,000 for $500,000 coverage.

--A campground in Hagerstown, Maryland last year was charged less than $1000 for $1 million in coverage. This year the same coverage costs $8000.

--A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

--An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

--A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984-1985 and 50% between 1985-1986.

--A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. This year the premium is $150,000 with a $50,000 deductible. This year's policy would also require the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

--An elevator repair and maintenance company on Staten Island paid $3500 for $5 million coverage in 1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier has offered coverage for $72,000 in annual premiums.

--An auto parts and towing company in Walton, Ohio is being charged $20,000 this year for coverage which cost $11,000 last year.

--An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

In addition to hearing directly from our own members, we have heard from hundreds of small businesses at the White House Conferences on Small Business. These conferences are being held in every state prior to the national conference, which will be held in Washington in August. At these conferences, small business owners vote on recommendations for federal action on small business issues. The top new issue coming out of these conferences is insurance. With over half of the conferences completed, insurance has emerged as the foremost concern aside from the budget and taxes.

Small business is in a Catch-22 situation when it comes to liability. Legal counsel at certain times and insurance all of the time are necessities. However, legal counsel is expensive; in-house counsel is out of the question. With regard to liability coverage, self-insurance, and in most cases group insurance, are not options for small business. Currently, obtaining certain lines of coverage on the open market may be virtually impossible.

We know that all types and sizes of businesses are experiencing a major problem with almost all commercial lines of insurance. We believe that the solution must be comprehensive enough to address what we see as the multiple causes of the problem.

The Causes

There is, as you know, disagreement on the circumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

One other group must be mentioned. The insurance commissioners have done little fingerpointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies widely from state to state.

We see some truth to all sides' arguments, and we propose consideration of several areas of reform. Before I elaborate, let me emphasize that we are still gauging membership opinion on most of these proposals.

The Solutions: Tort Reform

As you may know, NFIB is a charter member of the American Tort Reform Association (ATRA), a new coalition of business groups in favor of tort reform. NFIB membership supports tort reform at both the state and federal levels. In response to the question, "Do you favor or oppose comprehensive reform of the legal system to reduce litigation and limit the liability of defendants in civil suits?", our members voted 84% in favor, 5% opposed, 11% undecided. In twenty-four states, NFIB state directors have polled member opinions on various reforms of state tort law, and those results have likewise indicated their support. We support the following reforms, which many of the state legislatures are already considering:

1. Cap awards for noneconomic damages

2. Limit contingency fees

3. Implement alternative dispute resolution (ADR) mechanisms

4. Penalize parties that engage in frivolous litigation

5. Modify pure comparative negligence standards

6. Abolish joint and several liability

7. Require judges/juries to itemize elements of awards

8. Require judges/juries to consider collateral sources of compensation in determining awards

9. Eliminate "ad damnus" clauses

10. Allow payments of awards in installments

Solutions: Industry Reform

A major concern of ours is the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves.

At the state level, some insurance commissions have enacted temporary initiatives, such as moratoria on mid-term cancellations. Legislation is being considered in some states to require adequate notification periods and/or just cause for cancellations and nonrenewals. We support these actions as well as the formation of assigned risk pools and Market Assistance Programs (MAPs).

Another concern is the expanded use of claims-made policies for basic, commercial liability coverage. Claims-made policies are the insurance industry's immediate answer to the problem of unavailability because this type of coverage reduces the financial exposure of the insurance companies. According to industry representatives, claims-made policies are less expensive than occurrence policies. However, the cost of retroactive coverage to insure against liability incurred prior to the effective date of a claims-made policy, known as a "tail," will most likely neutralize, if not outweigh, any savings accrued through the initial purchase of a claims-made policy.

Claims-made policies have already been approved by most state insurance commissions and are being written by many companies. We urge strict monitoring of the implementation of these policies. Such oversight should be undertaken at the state level and possibly at the federal level as well. At the very least, insurance agents should be required to indicate clearly to policyholders the differences between the conventional occurrence policy and claims-made.

Solutions: Regulatory Reform

The existing regulatory system does not work. In contrast to the regulation of utilities, regulation of the insurance industry has not maintained available and affordable service, nor has it preserved the financial health of insurance companies. Insurance commissioners are charged with the responsibility of ensuring that rates are not "inadequate," "excessive," or "unfairly discriminatory," but the industry itself admits that policies were underpriced in the late 70's and early 80's. Many would contend that current premiums are excessive. Perhaps part of the problem is understaffing of commissioners' offices, which might be solved by earmarking more of the revenue collected in state premium taxes for this purpose.

The real problem, though, may be the political feasibility of a commissioner executing the powers of office. Consumers like low rates, and commissioners because they are either elected or appointed, like to please consumers. Without protection from public pressure, they may not be able to make unpopular decisions. One way to diffuse the political heat would be to create multi-member insurance commissions similar to the structure of most public utility commissions.

Another approach would be to establish statutory minimum standards pertaining to the financial condition of insurance companies. Such standards might be derived from the leverage and exposure ratios currently developed on an advisory basis by the

National Association of Insurance Commissioners (NAIC) for use by insurance companies and commissioners.

We do not at this time have a recommendation on whether industry and regulatory reforms should be undertaken at the federal level. However, we urge Congress to consider the reforms mentioned and to examine two other potential areas of concern. The McCarran-Ferguson Act has long been a source of controversy, but whether or not modification or repeal would improve the availability and affordability of insurance is uncertain. The other area of concern is reinsurance. The alleged influence of reinsurers over insurers has been publicized, as has the presence of foreign reinsurers in the American market. More information is needed in this regard.

Thank you for the opportunity to participate in this hearing. We look forward to working with you, Mr. Chairman and members of the committee, as you continue your consideration of insurance availability and affordability.

227T

NFIB® National Federation
of Independent Business

The Guardian of Small Business

January 21, 1986

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MEMORANDUM

TO: John Motley
Federal Legislative Staff

FROM: Sally Douglas

SUBJECT: State Ballot Questions

David Stephenson has recently sent a memo to all state directors regarding state ballot results on tort reform and insurance. You should have received a copy.

Leslie Christensen has regrouped the ballot questions by category. As you can see from the attached lists, there are 11 categories of tort reform questions, six categories on cost, availability, and general impact of insurance, and four final questions on liability insurance reform.

Attachment
cc: David Stephenson
2938D

Government Relations and Research Office
600 Maryland Ave., S.W., Suite 700
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Ballot Questions on Tort Reform

1. Punitive Damages
2. Pain and Suffering
3. Contingency Fees
4. Comparative Negligence
5. Prejudgement Interest
6. Mandatory Arbitration
7. Joint and Several Liability
8. Statute of Limitations
9. Workers' Compensation
10. General Tort Reform
11. Other

* An asterisk denotes a question which is listed under more than one heading.

PUNITIVE DAMAGES

AL	Should legislation be adopted which would limit the amount of punitive damages which a jury can award in a civil action? (85-11-4)
AL	Should the Legislature pass a bill placing a restriction on the amount of damages which may be awarded in a medical malpractice case in Alabama? (84-12-4)*
CO	Should legislation be enacted to limit punitive damage awards? (87-9-4)
CO	Should legislation be enacted to abolish punitive damage awards? (50-38-12)
FL	Should a cap be placed on the amount of awards for over and above the amount granted for actual damages, i.e. punitive damages? (90-5-5)*
IN	Should legislation be enacted limiting the amount of punitive damages that can be awarded by a court? (90-6-4)
KY	Should legislation be enacted limiting the amount of punitive damages that can be awarded by a court? (83-7-10)
MN	Should Minnesota enact legislation that would allow insurance companies to be sued for punitive damages due to alleged unfair claim practices? (30-54-16)
MT	Should legislation be enacted to place an upper limit on punitive damage awards? (86-8-6)
ND	Should legislation be enacted to limit punitive damages awards? (89-9-2)
OK	Should a cap be placed on the amount of awards for pain and suffering and punitive damages that could be awarded in lawsuits? (84-11-5)
SD	Should lawmakers pass legislation that would limit punitive damages? (84-7-9)

TX	Should legislation, including one or more of the areas listed below, be enacted that would stabilize general liability insurance rates? (73-11-6) (Reforms discussed included joint and several liability, collateral source rule, structured awards and punitive damages.)
WY	Should the legislature put caps on the amount of awards for punitive damages? (90-6-4)

PAIN AND SUFFERING

AL	Should the Legislature pass a bill placing a restriction on the amount of damages which may be awarded in a medical malpractice case in Alabama? (84-12-4)*
AR	Should the constitutional prohibition against statutory limitations on the amount of recovery for compensation and punitive damages for personal injuries be repealed? (70-21-4)
FL	Should a cap be placed on the amount of awards for over and above the amount granted for actual damages, i.e. punitive damages? (90-5-5)*
IN	Should limitations be imposed on the amount that courts may award for pain and suffering in personal injury cases? (90-6-4)
KY	Should limitations be imposed on the on the amount that courts may award for pain and suffering in personal injury cases? (83-9-8)
NV	Should specified caps be placed on the amount of awards for pain and suffering that could be awarded in lawsuits? (77-17-6)
NM	Should specified caps be placed on the amount of awards for pain and suffering that could be awarded in lawsuits? (79-12-9)

OK	Should a cap be placed on the amount of awards for pain and suffering and punitive damages that could be awarded in lawsuits? (84-11-5)*
OR	Should a cap be placed on the amount of awards for pain and suffering that could be awarded in lawsuits? (92-5-3)
WA	Should specified caps be placed on the amounts of awards for pain and suffering that could be awarded in lawsuits? (82-12-6)

CONTINGENCY FEES

IN	Should restrictions be legislated to limit the amount of payment that attorneys may receive in contingent fee cases? (93-5-2)
KY	Should restrictions be legislated to limit the amount of payment that attorneys may receive in contingent fee cases? (89-6-5)
NV	Should an attorney's contingency fee be set by a sliding fee schedule based on the amount of the court award? (61-31-8)
NM	Should an attorney's contingency fee be set by a sliding fee schedule based on the amount of the court award? (56-33-11)
SD	Should a party defending a claim be entitled to attorney's fees if a decision is reached in his favor? (84-10-6)
WA	Should an attorney's contingency fee be set by a sliding fee schedule based on the amount of the court award? (59-27-14)
WY	Should attorneys' contingency fees be set by a mandatory sliding fee schedule based on the amount of the court award? (72-19-9)

COMPARATIVE NEGLIGENCE

KS Should the Legislature approve a change in the Kansas tort laws to a system of pure comparative fault in tort cases? (39-26-35)

PREJUDGMENT INTEREST

ID Should the Idaho Legislature enact a law that would give a winning plaintiff prejudgment interest on the final judgment awarded starting at the date of injury or the date of the filing of the lawsuit? (29-56-15)

MANDATORY ARBITRATION

HI Should Hawaii have a mandatory arbitration for business disputes? (74-13-13)

JOINT AND SEVERAL LIABILITY

FL Should the legislature repeal the concept of joint and several liability? (89-5-6)

HI Should Hawaii adopt a law whereby persons responsible for an injury, negligence, or damage be held responsible based solely on the percentage of fault found? (85-5-10)

NV Should the joint and several liability rule be changed to prohibit the injured person from collecting damages for pain and suffering from a liable person in an amount which exceeds the liable person's degree of fault? (75-16-9)

NM Should the joint and several liability rule be changed to prohibit the injured person from collecting damages for pain and suffering from a liable person in an amount which exceeds the liable person's degree of fault? (79-14-7)

WA	Should the joint and several liability rule be changed to prohibit the injured person from collecting damages for pain and suffering from a liable person in an amount which exceeds the liable person's degree of fault? (80-11-9)
WY	Should the joint and several liability rule be changed to prohibit the injured person from collecting damages for pain and suffering from a liable person in an amount which exceeds the liable person's degree of fault? (87-7-6)

STATUTE OF LIMITATIONS

CO	Should a shorter period of time be allowed for beginning lawsuits? (75-18-7)
SD	Should a shorter period of time be allowed for commencement of lawsuits? (69-13-18)

WORKERS' COMPENSATION

CO	Should a worker be entitled to workmen's compensation benefits for illness attributed to work stress? (6-90-4)
NV	Should the law be amended to allow suit against the employer by an injured worker under some circumstances as an additional remedy to that provided in the industrial insurance system? (5-94-1)

GENERAL TORT REFORM

GA	Should the General Assembly reform the Georgia system of tort law affecting methods of assessing civil damages in liability cases to help lower the cost of various types of business liability insurance? (89-4-7)
IA	Should the Legislature place limits on jury awards and punitive damages, and/or make other reforms in the legal tort system in an effort to try to reduce recent large increases in premiums for property/casualty and product liability insurance? (86-9-5)

SD	Should the legislature take steps to hold down the cost of general liability insurance for business? (79-16-5)
TX	Should legislation, including one or more of the areas listed below, be enacted that would stabilize general liability insurance rates? (73-11-6) (Reforms discussed included joint and several liability, collateral source rule, structured awards and punitive damages.)

OTHER

AL	Should the Alabama Legislature adopt legislation which would abolish Alabama's Scintilla of Evidence Rule? (87-7-6)
WY	Should the Legislature allow periodic payment of personal injury damages rather than a lump sum payment? (74-14-12)

Ballot Questions on Liability Insurance Costs, Availability, and General Impact

1. Difficulty in obtaining/reduced protection
2. Cancelled
3. Going without
4. Increased premiums
5. Claims experience
6. Workers' Compensation

DIFFICULTY IN OBTAINING/REDUCED PROTECTION

AZ	Has your business experienced any difficulty in obtaining liability insurance? (31-66-3)
AZ	If insurance has been cancelled, have you been able to obtain liability insurance from another carrier? (69-18-13)
NV	Have you been forced to reduce protection, i.e. increased deductible, reduced coverage limits, or the like? (40-59-1)
NM	Have you been forced to reduce protection, i.e. increased deductible, reduced coverage limits, or the like? (45-50-5)
WA	Have you been forced to reduce protection, i.e. increased deductible, reduced coverage limits, or the like? (37-61-2)

CANCELLED

AZ	Has your business liability insurance been cancelled within the past year? (9-89-2)
NV	Over the past three years, has your general liability insurance been cancelled? (13-86-1)
NM	Over the past three years, has your general liability insurance been cancelled? (24-70-6)
WA	Over the past three years has your general liaiblity insurance been cancelled? (14-85-1)

GOING WITHOUT

AZ	Is your business currently going without liability insurance because the cost is prohibitive? (9-89-2)
IN	Have you been unable to obtain casualty or liability insurance for your business? (19-77-4)
KY	Have you been unable to obtain casualty or liability insurance for your business? (26-71-3)
NV	If you had coverage cancelled, were you able to obtain coverage through another carrier? (79-21-0)
NV	Is your business presently going without liability coverage because of its cost? (12-87-1)
NM	If your coverage was cancelled, were you able to obtain coverage through another carrier? (82-6-12)
NM	Is your business presently going without liability coverage because of the cost? (23-72-5)
WA	If your coverage was cancelled, were you able to obtain coverage through another carrier? (77-14-9)
WA	Is your business presently going without liability coverage because of its cost? (7-92-1)

INCREASED PREMIUMS

AZ Has your business liability insurance premium increased within the past year for the same amount of coverage? (81-14-5)

AZ How much of a premium increase did you experience?

Less than 10%	(10%)
10% to 24%	(25%)
25% to 49%	(21%)
50% to 99%	(16%)
100% to 500%	(27%)
More than 500%	(1%)

IN Have the premium costs for your business casualty and liability insurance increased significantly during recent years?

More than 50%	(29%)
Between 25% & 50%	(27%)
Between 5% and 25%	(29%)
No significant increase	(10%)
Unknown	(5%)

KY Have the premium costs for your business casualty and liability insurance increased significantly during recent years?

More than 50%	(26%)
Between 25% & 50%	(36%)
Between 5% & 25%	(26%)
No significant increase	(6%)
Unknown	(6%)

NE Has your business operation experienced escalating premium costs for maintaining general business liability insurance protection? (84-16)

NE If you have experienced premium increases, by what percentage has your current premium increased over last year's premium?

0 to 9%	(16%)
10 to 19%	(28%)
20 to 29%	(19%)
30 to 39%	(14%)
40 to 49%	(6%)
Over 50%	(17%)

NV Over the past three years, have you experienced a rate increase in your general liability insurance for the same level of coverage? (86-13-1)

NV If you experienced a rate increase, how much was the increase?

Between 0 & 25%	(52%)
Between 25 & 75%	(22%)
Between 75 & 100%	(15%)
Between 100 & 150%	(4%)
Between 150 & 200%	(3%)
More than 200%	(4%)

NM Over the past three years, have you experienced a rate increase in your general liability insurance for the same level of coverage? (81-15-4)

NM If you experienced a rate increase, by how much did it increase?

Between 0 & 25%	(41%)
Between 25 & 75%	(37%)
Between 75 & 100%	(13%)
Between 100 & 150%	(4%)
Between 150 & 200%	(1%)
More than 200%	(4%)

SD What has been the approximate increase over the past three years in the cost of general liability insurance for your business?

0 to 10%	(11%)
10 to 25%	(26%)
25 to 50%	(26%)
50 to 100%	(16%)
Over 100%	(15%)
No information	(6%)

SD For which type of insurance have you experienced the greatest premium increase during the past three years?

Product liability	(22%)
Property	(11%)
Workers' compensation	(11%)
General liability	(56%)

WA Over the past three years, have you experienced a rate increase in your general liability insurance for the same level of coverage? (83-14-3)

WA

If you have experienced a rate increase, by how much did it increase?

Between 0 & 25%	(35%)
Between 25 & 75%	(32%)
Between 75 & 100%	(12%)
Between 100 & 150%	(8%)
Between 150 & 200%	(2%)
More than 200%	(11%)

CLAIMS EXPERIENCE

FL

Has your business been forced to pay a damage claim because you were the only party to the damage suit who had insurance or the ability to pay the claim? (9-91)

NV

In the past three years have you had any claims against your general liability insurance? (18-82-0)

NM

In the past three years, have you had any claims against your general liability insurance? (35-62-3)

WA

In the past three years, have you had any claims against your general liability insurance? (17-82-1)

WORKERS COMPENSATION

HI

Should Hawaii law be changed so as to permit small employers in similar businesses to group together for self-insurance for workers' compensation? (76-17-7)

HI

Should a competitive state fund for workers' compensation insurance be established? (30-60-10)

MN

Have you had a workers' compensation claim in the past five years? (40-59-1)

MN

Has your workers' compensation insurance premium increased in the past year? (78-17-5)

MN

Have you reduced the number of full-time employees because of workers' compensation costs? (29-68-3)

MN	Have you postponed adding new employees because of workers' compensation costs? (47-48-5)

BALLOT QUESTIONS ON LIABILITY INSURANCE REFORMS

FL	Should small business owners be allowed to pool their insurance premiums and thus self-insure their business liability in the way big business self-insures itself? (70-15-15)
FL	Should the Insurance Commissioner have the ability to regulate insurance rates in the liability/casualty area like he does in the health and auto insurance area? (71-22-7)
FL	Should the insurance companies be forced to give written notice to business policyholders regarding cancellation, renewal and new premium changes? (92-6-2)
GA	Should laws and regulations regulating insurance companies be amended to insure that businesses have reasonable methods of obtaining and maintaining liability insurance coverage? (85-7-8)

2918D

Mr. GUARINI. Thank you very much, Mr. Motley.
Mr. Stanton.

STATEMENT OF DAVID A. STANTON, MANAGER OF ADMINISTRATION, LENAPE FORGE, INC.

Mr. STANTON. Mr. Chairman and members of the committee, I appreciate having the opportunity to testify before this committee today to talk about the fact that small businesses today are facing a terrible crisis when it comes to liability insurance.

The company that I represent is called Lenape Forge. We are a small custom forging manufacturer located in West Chester, PA, which is approximately 30 miles from Philadelphia. We employ approximately 110 people and have been in business for over 60 years. Our products serve oil, gas, defense, and general industrial markets.

We are facing a problem which threatens to destroy our business and to destroy the businesses of many other companies. In addition to unreasonably large increases in rates, coverage is often unavailable regardless of the cost.

In our last policy year, Lenape Forge carried property insurance, a $1 million liability policy, and a $10 million umbrella liability policy, and the cost of these coverages were approximately $40,000.

Shortly before our policy expiration date, we were advised by our carrier that coverage would not be renewed. This refusal to renew occurred even though there were no losses in the policy year. In fact, in its 60-year history, Lenape Forge had never had a products liability loss.

We were faced with a double-edged sword. In the insurance industry's opinion, if you have recently incurred losses, you are considered a bad risk; and conversely, if you have not had any losses for a long period of time, then you are, obviously, imminently due to have a catastrophe and therefore you are a bad risk.

We diligently shopped for insurance and received over 20 rejections. The reasons for rejection were usually that the insurance company was not accepting any new business or that they "did not want to insure our type of business." The lowest price we could find was $217,000 for property and liability coverage similar to last year's coverage. Even at that price, we could only find a $1 million umbrella policy, and deductibles were increased from $15,000 to $100,000.

We were faced with a 500-percent increase in costs from $40,000 to over $200,000 to acquire significantly less coverage. This simply could not be passed on to our customers. We are in a business which faces significant foreign competition. Overseas companies are not facing the same insurance crises as the U.S. manufacturers.

Some of our domestic competitors who were fortunate enough not to be cancelled by their insurance carriers were able to get by with increases in the 40- to 50-percent range.

Assuming that we couldn't pass increases on to our customers, we would have to increase our sales by 20 to 25 percent in order to offset this additional cost. An increases in sales of that magnitude was simply impossible, so instead, we chose to eliminate product liability coverage and retain only property and general liability insurance.

By making these drastic changes, we were able to limit our insurance cost increases to a modest 100 percent.

The insurance companies contend that they have suffered significant losses in recent years. They feel large increases are warranted in order to ensure their financial well-being. The magnitude of the increases, coupled with the uniform application by all the large carriers, is reminiscent of the oil crisis of the midseventies, insurance has become that crisis in the 1980's.

Businesses are unable to adequately insure themselves at today's exorbitant rates. They are faced with going broke in attempting to pay for adequate coverage or going out of business if hit with a major loss. We are all faced with an extremely difficult problem. It is economically irresponsible to allow businesses to go out of business because of increased insurance costs, and at the same time, it is socially irresponsible to allow injured parties to go without some kind of remedy.

We are asking for your assistance in several areas. First, we feel that insurance companies must be prohibited from canceling policies without cause. Second, we feel that an investigation should be launched into the insurance companies' pricing policies, and we commend you for working in that area today.

And finally, we feel there must be meaningful changes to our civil justice system. Tort law must be changed to eliminate windfall benefits while adequately protecting injured parties.

Thank you very much.

Mr. GUARINI. Thank you very much, Mr. Stanton.

Betty Wilson.

STATEMENT OF BETTY WILSON, PRESIDENT, CENTER FOR NON-PROFIT CORPORATIONS, INC.

Ms. WILSON. Congressman, thank you very much—to you and the chairman and the members of the committee—for holding these hearings and for inviting me to come and give testimony.

I am going to speak about the experience that non-profits are having with this crisis. It is very much like that of small businesses because, in fact, we are running small businesses.

Thousands of New Jersey nonprofit groups and the millions of people that they serve each year are suffering from this liability insurance crisis. Staggering premiums, threats of cancellation and nonrenewal, reductions in coverage, and demand for payment within a few days are all too common over the past 8 or 9 months.

I would like to describe to you some examples of cases that have been reported to the Center for Non-Profits, and these are just a sampling. We have many, many more.

One multiservice community-based organization in northern New Jersey in an urban county that provides day care, provides services for the elderly, provides tenant counseling, a shelter for juveniles, last October had their premium doubled, and they could not afford the new $20,000 premium. This is an organization, incidentally, which does receive social service block grant funds.

They shopped around for another policy and they found an Arizona company that would be willing to write coverage for them; however, even though the premium was less, they were going to offer less coverage. They knew it was all they could afford, so they saw it as their only option.

At Christmas time they had collected and purchased toys for the neighborhood children for Christmas, and their building was broken into, the toys were stolen and their computers were stolen. The loss suffered was not covered by the new insurance policy.

An arts, music school, and cultural center in south Jersey was notified one Friday in November 1985 that they had until 4 o'clock that afternoon to choose to renew their liability insurance at nearly 10 times their last year's premium or they would be dropped for nonrenewal. They paid because they had no alternative.

A food bank in Essex County that provides food at little or no cost for groups serving the poor and the needy was given 2 days to pay a renewal premium of $5,900 for their directors' and officers' liability coverage. Last year the policy cost $590.

A Head Start agency was slapped with a premium increase of 2,000 percent. When their renewal policy came, the premium went from $631 to $13,200. After shopping around, they found another company that would insure them for $6125. Though nearly 10 times their cost of last year, it looked like a bargain.

A community mental health center in Camden County that works with deinstitutionalized mentally ill people recently expanded its services to the entire county and changed its name. Their coverage as a result was cut from $1 million to $100,000 in midstream, and they had to beg for that because the company threatened to cancel them.

A YWCA in Camden is paying almost 300 percent more in premium for reduced coverage, and their director wrote to me and said,

> It is impossible for an agency such as ours to pass along even a portion of the rate increase to our customers. We are providing primarily child care services at our Camden site. In Camden the average per capita income falls 16 percent below the poverty level.

The situation was the same at their women's shelter, where the rate increase from 1985 to 1986 was a staggering 500 percent. They paid more and they got less.

Nonprofits can't run the risk of running bare. Their boards are made up of volunteers, and volunteers cannot be expected to take the risk of serving out of the goodness of their heart, in most cases, and take the personal risk because their organization cannot cover them with liability insurance.

I should note here that New Jersey regulations introduced last September and still in effect prohibit cancellations during the policy life and require policies to be renewed with the same coverage as was previously provided. There is no control, however, over the premiums, and what has happened is that the premiums have gone up so much that there has been de facto cancellation.

Those regulations which have provided a modicum of protection at least guarantee that there would be something available even though the prices were out of sight. Those regulations have now been proposed for repeal, and we are deeply concerned.

None of this has anything to do with claims. Not a single one of the organizations that I reported to you had any claims. They had no claims whatsoever. In fact, the New Jersey Department of Human Services conducted a survey to find out whether day care centers were responsible for a large number of claims, and they found quite the contrary. They found that 81.3 percent of the day care centers that they surveyed reported no claims at all for the 5-year period from 1980 to 1985, and of the claims that were settled, 67 percent involved awards of under $200 each.

Refuting claims about child sexual abuse risks in day care settings, in the Department of Human Services survey, they reported that of the 44,000 reported cases of abuse and neglect in 1984, only 200 involved child care centers, and that is less than one-half of 1 percent. Only 18 of those 200 were substantiated.

Nonprofits are especially vulnerable in the current crisis. Most do not have the financial reserves to cover these huge premium increases. These are groups that our country relies on to provide essential community services, often to our neediest citizens. In most cases, the prices cannot be raised. We can turn only to private contributors or to Government to help pay these added insurance costs. That means that hard-won charitable gifts, client fees and taxes will be spent for insurance premiums rather than to care for children, the sick, the elderly. This is neither good sense nor is it good public policy. And I would add here that the other alternative here is to close down some programs, and that is happening.

We believe that significant institutional change is needed to halt the crisis and to stem the cycle of insurance crises in the future. We recommend that Congress assume a role in insurance regulation and standard setting.

I submitted my statement for the record, so I won't go through all of the recommendations that we are making, but there is one that I want to call to your attention, and it has come up here today again and again and again. That is the need for good information.

We believe that Congress should require disclosure of insurance industry data and information on income and claims paid. Only then can accurate assessment be made as to whether the rates are reasonable and substantiated.

In a statement from the New Jersey Department of Public Advocate to the New Jersey Insurance Department on a proposed exclusion of certain coverages from commercial liability insurance policies, the public advocate states that the "Public advocate has been very troubled by the lack of hard, empirical data." He describes the industry as "intransigent." He reports that the industry has not provided the actuarial information which would "objectively verify the actual extent of losses."

"The industry has not demonstrated that substantial changes in coverage or withdrawal from a particular line are necessary," according to the public advocate. He goes on to say that it all suggests a "calculated effort to use these unrepresentative figures to manipulate public policy."

He concludes with: "This lack of data is even more intolerable in view of the fact that many of the proposals that have been made by the insurance industry would have a dramatic effect on social and public policy in New Jersey. Because of the critical role insurance coverage plays in our society, any changes which would limit the availability or the protection it provides should be scrutinized with the utmost care."

In conclusion, I want to thank you for holding this hearing and for your concern and interest. The people I work with and the people they serve are suffering from this crisis that they did not cause, for which they bear no fault, and over which they have no control. We ask for your help in bringing equity and justice to the insurance system in our country and to relieve the hardships we are suffering under.

Thank you.

[The prepared statement follows:]

CENTER
FOR
NON-PROFIT
CORPORATIONS

Testimony of
Betty Wilson, President
Center For Non-Profit Corporations, Inc.
before the
Subcommittee on Oversight
of the
Committee on Ways and Means
U.S. House of Representatives
The Hon. J.J. Pickle, Chairman
March 13, 1986

Thousands of New Jersey non-profit groups and the millions of people they serve each year are suffering from the liability insurance crisis. Staggering liability insurance premium increases, threats of cancellation and non-renewal, reductions in coverage and demand for payment within a few days are all too common practices over the last eight or nine months in New Jersey. Until premiums are brought under control and good sense returns to the insurance marketplace, the problem will worsen.

I would like to describe just a sampling of the many cases that have been reported to us at the Center.

The liability insurance premium was doubled for a multi-service community based organization that provides day care, tenant counselling, a shelter for juveniles and other services in a low income urban neighborhood, last October. They could not afford the new $20,000 premium. They shopped around for another policy and found an Arizona Company that wrote a policy at lower cost but also offered less coverage. They felt they had no choice but to take what they could afford. At Christmas time, their building was broken into and the toys they'd collected for neighborhood children for Christmas gifts and their computers were stolen. The new policy didn't cover the loss.

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An arts and music school and cultural center in South Jersey was notified, one Friday in November, that they had until 4:00 p.m. that day to choose to renew their liability insurance, at nearly ten times their last year's premium or be dropped for non-renewal. They paid because they had no alternative.

A food bank in Essex County that provides food at little or no cost, for groups serving the poor and needy, was given two days to pay a renewal premium of $5900 for their Directors and Officers Liability policy. Last year the policy cost $590.

A Head Start agency was slapped with a premium increase of 2000%. When their policy renewal came, the premium went from $631 to $13,200. After shopping around they found another company that would insure them for $6,125. Though nearly ten times their cost of last year, it looked like a bargain.

A community mental health center in Camden County that works with deinstitutionalized mentally ill people, recently expanded its services to the entire county and changed its name. Their coverage was cut from $1 million to $100,000 in mid-stream.

One Head Start agency in Passaic County, was first threatened with non-renewal and then was given verbal assurances that the company would renew. More than a month after the policy year ended, they still had no renewal policy, no binder and no bill. Six weeks into the policy year a three-month binder came and a bill for a deposit that was equal to the previous year's full premium. Almost three months into the policy year they were billed $8,850 for coverage that cost $2,500 the year before.

A YWCA in Camden is paying almost 300% more in premium for reduced coverage. Their director writes:

> "It is impossible for an agency such as ours to pass along even a portion of the rate increase to our customers. We are providing primarily child care services at our Camden site. In Camden, the average per capita income falls 16% below the poverty level, and the Brookings Institute has described the city as the ninth most distressed in the nation. Nor are we able to pass along the rate increase to our primary funding sources, the United Way of Camden County and the State of New Jersey (Division of Youth and Family Services).
>
> The situation with Professional Liability Insurance which we carry for the counseling staff at our battered women's shelter (SOLACE) is similar. In this case, our policy was renewed, but the rate increase between 1985 and 1986 was a staggering 500%. Once again, the new policy with the higher rates provides reduced coverage."

Non-profit groups can't afford to take the risk of "running bare" - operating without liability coverage. Prudent management compels a non-profit board of trustees to carry liability insurance. Furthermore, non-profits with state contracts are also required by law to carry it.

It is not that these organizations have filed a lot of claims or have had large judgments paid out on their behalf. In no case reported to us was there any record of claims made or paid. All the evidence we have shows that bad claims experience plays no part in the rising insurance costs. In fact, a survey of New Jersey day care centers shows they're such good risks that insurers ought to be clamoring for their business. According to a report from Nicholas Scalera, Assistant Director of the New Jersey Division of Youth and Family Services, 81.3 percent of day-care centers surveyed reported no claims over the 1980-1985 period. Of the claims settled, 67 percent involved awards of under $200 each.

Refuting claims about child sexual abuse risks in day-care settings, Scalera said, "Of 44,000 reported cases of abuse and neglect in 1984, only 200 involved child-care centers. Only 18 of the 200 were substantiated." That's less than one-half of 1 percent.

Insurance companies are businesses and are entitled to make a reasonable profit. And non-profits are willing to pay a fair price for a quality product. In New Jersey alone we estimate non-profits paid $50 million or more every year in premiums -- and that's before the prices went up. We're not asking for a free ride.

Yet, the insurance industry should not possess unbridled flexibility to raise premiums suddenly, capriciously and without warning. Poor business judgment within the insurance industry is largely responsible for the current crisis. Insurance companies miscalculated in the early '80's when they were in hot pursuit of premium dollars. They then failed to heed early warnings of the impending crisis which were evident as long as two years ago.

In a last-minute scramble to recover, the insurance industry has effectively redlined whole segments of the economy -- non profits, governments and some businesses. They've gone too far.

Non-profits are especially vulnerable in the current crisis. Most do not have financial reserves to cover huge premium increases. These are groups that our country relies on to provide essential community services, often to our neediest citizens. In most cases prices cannot be raised. We can turn only to private contributors or to government to help them pay these added insurance costs. That means that hard-won charitable gifts, client fees and taxes will be spent for insurance premiums rather than to care for children, the sick and the elderly. That is neither good sense nor good public policy.

We believe that significant institutional change is needed to halt this crisis and to stem the cycle of insurance crises in the future. We recommend that Congress assume a role in insurance regulation and standard setting.

Our State Insurance Department is too understaffed, especially with actuaries, to keep on top of insurance rate and policy changes. Information on rate changes was reported to the department in the years after deregulation. Yet, reports either went unread or warning signs unnoticed, allowing the current situation to build to a crisis. Congressional oversight is needed to support the states.

The insurance industry is national, even international in scope. No single state can hope to have the resources or the power to protect its citizens from forces so far outside its control. For example, one international company writes much of the reinsurance for U.S. insurance companies. They have refused to provide reinsurance in many cases, leaving American property and casualty companies without needed reinsurance. Action by Congress is needed to guarantee that reinsurance will be available at a reasonable cost.

Congress should consider a system to guarantee that liability coverage will be available at reasonable rates to all. The system could be similar to the FAIR plan which was set up to guarantee fire insurance in urban areas after the riots of twenty years ago. Or, Congress could establish national standards for states to set up such plans. Such a plan need not cost the taxpayers anything because it could be paid for out of premiums. I am told that the federal government made money on such insurance in the past.

We support H.R. 4301 sponsored by Congressman Wyden and S-2129 sponsored by Senators Kasten, Danforth, Hollings and Rockefeller. We believe this proposed legislation which removes impediments to risk pooling for general liability coverage, will provide limited relief for some organizations.

Finally, we believe Congress should require disclosure of insurance industry data and information about income and claims paid. Only then can an accurate assessment be made as to whether rates are reasonable and substantiated. New Jersey's Department of Public Advocate's statement to the New Jersey Insurance Department on "the Proposed Exclusion of Certain Coverage from Commercial Liability Insurance Policy Forms" (March 6, 1986) says:

> "While New Jersey and the rest of the country have been barraged over the past few months with a variety of lamentations and anecdotes from the insurance industry, the Public Advocate has been very troubled by the lack of hard, empirical data to back up the industry's rate increases and reductions in coverage. Despite repeated calls for this data from this Department, other public officials and concerned individuals, the industry has been intransigent in its refusal to disclose this vital information. Instead, the industry's positions and actions have often been premised on mere conjecture and subjective speculation. Requests for significant changes in coverage have thus been made without the industry ever providing the actuarial information which would objectively verify the actual extent of losses incurred by the industry in providing the particular coverage. Of equal importance, the industry has not demonstrated that substantial changes in coverage or withdrawal from a particular line are necessary to alleviate any legitimate problems insurers may have. Indeed, when limited empirical information is made available, it is never set in the context of being cycle-bottom data, suggesting a calculated effort to use these unrepresentative figures to manipulate public policy.
>
> This lack of data is even more intolerable in view of the fact that many of the proposals that have been made by the insurance industry would have a dramatic effect on social and public policy in New Jersey. Because of the critical role insurance coverage plays in our society, any changes which would limit the availability or the protection it provides should be scrutinized with the utmost care."

In conclusion, I want to thank you Mr. Chairman and members of the Committee for your concern and interest. The people I work with and the people they serve are suffering from this crisis which they did not cause, for which they bear no fault and over which they have no control. We ask your help in bringing equity and justice to the insurance system in our country and to relieve the harships we are suffering under.

Mr. GUARINI. Thank you very much, Betty.

We will recess for 20 minutes. There are two votes and the panel will come back after that. In the meantime, just stay around.

Ms. WILSON. Fine.

Mr. GUARINI. Thank you.

[Recess.]

Chairman PICKLE. The subcommittee will come to order again, and I want to apologize to our witnesses. This has been a busy day for the subcommittee and a busy day on the floor, and we still have a vote or two left. I believe, though, we can proceed now without further interruption. So we thank you for your indulgence.

I recognize again Congressman Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Motley, I believe it was Mr. Stanton who said the increases that might increase the cost of their product 20 to 25 percent—was that—or did you say that, John?

Mr. STANTON. I think that I made the comment that because we could not pass through price increases, we would have to increase our volume of sales by 20 to 25 percent to offset those insurance increases.

Mr. SCHULZE. My question, John, is are you finding that other small businesses have this same problem, and are they having to pass this along? Also, what percentage of their gross volume is paid for insurance? Is it rising or is it staying about the same? What kind of impact is this going to have on competitiveness?

Mr. MOTLEY. Well, Congressman Schulze, the typical small business is generally not a pricesetter in the marketplace. The competition in the small business community is usually so vigorous, either from the larger chains or from bigger businesses or from whomever, that generally what they can charge for a product—just like Mr. Stanton said, that they are having tremendous competition from overseas and therefore can't increase their prices. I think you will find a very similar situation in almost every small business situation.

The construction industry, for example, is probably the most small business-dominated industry in the United States. So you are going to find a highly competitive situation. In that situation they are simply not going to be able to pass on very easily these increased costs.

What we find happening is that businesses are going bare, and they are taking the chance, and it's a very difficult one, because again if they have that one claim filed against them, they are generally out of business.

But a lot of them feel that they simply cannot pay these exorbitant increases that are coming down for the cost of insurance.

Mr. SCHULZE. So would you say a lot of them are going bare?

Mr. MOTLEY. Definitely a lot of them are going bare.

Mr. SCHULZE. Mr. Stanton, would you take advantage of a tax-exempt self-insurance account if one were available? Since you've never had a claim against you and your policy was canceled, would this be an effective way to help small or medium-sized businesses insure?

Mr. STANTON. There would be some possibility for us to take advantage of such a program. However, there's a problem also, and that is you have to put up capital in order to make sure that you are adequately self-insured. We would certainly like to take advantage of something like that. I don't know whether it would be financially feasible.

Mr. SCHULZE. If you could pool your funds with other forges around the country to purchase insurance or sort of form your own company, would you be interested in that kind of approach?

Mr. STANTON. It's something which is under consideration now. I understand that the forging industry association is contemplating such a program.

Mr. SCHULZE. Do you directly compete with foreign competition?

Mr. STANTON. In some circumstances, yes.

Mr. SCHULZE. If you had paid the full insurance premium, would that have made you noncompetitive to a slight degree, to a large degree?

Mr. STANTON. It would have done two things. It would have both made us noncompetitive and it would have gone a long way down the road to making us also unprofitable.

Mr. SCHULZE. Thank you for your testimony.

Thank you, Mr. Chairman.

Chairman PICKLE. I hope I'm not repeating any of the questions that might have been asked previously, but I want to ask Mr. Motley, are there any kinds of activities in your association's work on which you had insurance coverage the last several years for which now you cannot get coverage? Any type of insurance that has been lost?

Mr. MOTLEY. Within NFIB itself or for our members?

Chairman PICKLE. In the small business field, whether or not it's specifically an area represented by your organization.

Mr. MOTLEY. Well, within NFIB, I believe that we don't have directors insurance any longer because the costs went up astronomically.

Chairman PICKLE. Don't have what kind of insurance?

Mr. MOTLEY. Directors insurance for the board of directors. It went up several hundred percent, and they just decided not to carry it.

There are a series of examples——

Chairman PICKLE. Is that typical of other businesses across the country, they're not insuring their directors or their officers, or in the same amount?

Mr. MOTLEY. Yes, I'm pretty sure that it's very typical, Congressman Pickle. There is a series of examples in the beginning of my testimony. You know, there's an aircraft corporation in Waco, TX—funny I should pick Texas—paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

There is a five-and-dime store in New Lexington, OH, which has seen premiums increase 20 percent between 1984 and 1985, and 50 percent between 1985 and 1986. And there are many instances where the policies have been just canceled outright, and they shop for insurance, they can't find insurance at a reasonable price, and they just go bare.

In the self-insurance mechanism that Congressman Schulze was talking about, that is really probably only good for the most successful small businesses, the larger ones. The smaller ones simply do not have enough in profits and in sales to even consider self-insurance. So they go bare. That's the only choice available.

Chairman PICKLE. Well, do you think that the premiums are experience-rated, or are the premiums just something that the companies just set arbitrarily?

Mr. MOTLEY. The amount of investigation that we have done into it indicates to me that the premiums are extremely arbitrary. NFIB polled representatives of the insurance industry, independent insurance agents—Bob Hunter from the Nader group—and we held a 2-day seminar on this problem. And at the end of the 2 days, we had received the type of information that indicated that back in the 1970's and 1980's, that an awful lot of these insurance companies, in order to pull in the premium dollar, which an awful lot of people have testified to already, were selling at 100 percent below the manual rate. That's the rate that the ISO was telling them they should be charging for premiums to cover their liability down the line. So today they don't have the premium dollar coming in to cover that liability.

Chairman PICKLE. When we were having an organizational meeting on this subject, Mr. Schulze suggested we look into liability insurance primarily for small businesses. My question to you is whether small businesses today are finding it almost impossible or extremely expensive to get sufficient coverage at a reasonable rate?

Mr. MOTLEY. Yes, Mr. Chairman.

Chairman PICKLE. Is it a crisis situation?

Mr. MOTLEY. It is a crisis.

Chairman PICKLE. What would you recommend the Federal Government do about it?

Mr. MOTLEY. Well, we believe that there are several—there are basically two areas to address:

One of the areas is the civil justice system, and I think the Federal Government can show the way by addressing finally a national products liability law, including tort reform in that law.

There are several decent pieces of legislation that have been introduced, and I believe the administration is going to be moving forward with an initiative very soon in that area.

In addition to that, we do believe that the regulation or the business practices of the industry must be looked at. What you have is a situation where the regulation of the industry is so haphazard from State to State that in effect if one State tries to do a good job, the insurance companies can turn around and tell them, well, you know, we don't need to write insurance in this State. We'll just go across the border into Oklahoma and do it, or to New Mexico. We don't need to write insurance in the State of Texas, if they try to get too tough as far as their regulation is concerned.

So we do believe that the Congress has to take a look at this patchwork quilt which allows the insurance companies to operate in the economy without almost any regulation, and certainly they're not under the antitrust laws, either.

Chairman PICKLE. Thank you. It is a serious, serious problem, and we need to look into it thoroughly.

Mr. Guarini, do you have any questions of the panel?

Mr. GUARINI. Just very briefly.

Betty, you said that many nonprofits have very little losses and yet got insurance premiums up to 10 times what they were before. Does the State commissioner of insurance do anything to give you any relief in this regard? Is there any action being taken from the executive level?

Ms. WILSON. Some, but not nearly enough. And we have seen some backsliding in the last couple of weeks.

Mr. GUARINI. Well, what can the State do? Is there any authority in the State commissioner to help?

Ms. WILSON. The big problem in the State of New Jersey—I mean one of the big problems—is that the insurance department is so woefully understaffed. They have run most of the time in the last year or two with one actuary. They now have two. And they have this volume of reports that the companies are required to submit, but nobody has time to read them, it appears, or evaluate them.

Mr. GUARINI. Well, what I'm really talking about is do they have the authority to do anything? Is there any ability on their part to find the answers? Assume they had all the staff and all the money in the world.

Ms. WILSON. Well, they did do something last fall. They passed regulations that stopped insurance companies from canceling policies midstream and from refusing to renew, and those regulations are still in effect. The regulations were upheld in the courts, but now they have proposed their repeal.

The Public Advocate believes that the law contains authority for the commissioner to enter into rate cases, even since deregulation. So I don't think that the State is without tools. I think they are perhaps without as much will as we would like, and I think they are without a lot of manpower.

But many of these forces are totally outside their control. This reinsurance problem is totally outside the control of any individual State insurance department.

[The following letter was subsequently received:]

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RECEIVED
MAR 19 1986
WASH., D.C. OFFICE
Frank J. Guarini M.C

March 14, 1986

The Hon. Frank J. Guarini
2458 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Guarini:

This letter is a follow-up to my testimony before the Subcommittee on Oversight on March 13, 1986. I request it be made part of the official record of the hearing.

I am writing to give you additional information in response to your question about whether states have adequate authority to regulate the insurance industry in order to protect consumers.

I believe there are areas where only Congress and the federal government can exercise appropriate authority. They are:

- Only the federal government can exercise authority and control over international insurance bankers which, according to testimony from Lyndon L. Olson, Chairman of the Texas State Board of Insurance, write 67% of the reinsurance for the United States. No single state can possibly solve the problems related to reinsurance.

- Only the federal government can repeal the exemption of the insurance industry from federal anti-trust laws (McCarren-Ferguson Act).

- Congress should remove federal impediments to setting up risk pool trusts by groups who wish to self-insure. H.R. 4301 and S. 2129 would accomplish this.

- Because of the overriding public policy consequences of the insurance crisis, Congress should guarantee a back-up system that would assure availability of liability coverage in adequate amounts to all at reasonable rates. The system could be modelled after the FAIR plan which was set up to guarantee fire insurance after the urban riots twenty years ago. While individual states could pass laws to accomplish such relief, there is little indication of widespread action to do so.

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- National standards for disclosure and accountability should be established. As we heard repeatedly during the hearing, inadequate information makes judgments as to the fairness and equity of rates impossible. National standards would assure that insurers would not have to comply with fifty different sets of reporting requirements and would provide Congress with uniform data for oversight purposes.

New Jersey regulations currently protects against cancellation and non-renewal, though they do nothing about price. As I reported, we are deeply concerned at the recent proposal by the State Insurance Department to repeal those regulations. They had the power to impose those regulations but seem unwilling to keep them in place.

Pending New Jersey legislation would set up an excess liability commission to carry liability coverage over $500,000 for municipalities and non-profits; establish a structure for risk pook trusts; and exempt volunteer trustees from liability.

We believe the solution to our crisis will be a blend of federal and state laws. Action on existing federal laws, standard setting, disclosure and accountability and controls over the reinsurance industry are all beyond the ability of states; Congress should assert its authority.

William Anderson from the General Accounting Office reported at the hearing that the crisis had "turned the corner" in 1985 and he predicted it will ease off. I urge you to resist the temptation to conclude the problem is solved if that happens. Without structural changes, the insurance cycle will hit bottom again as it has regularly in the past.

My thanks again to you and to the Committee for inviting me to be a witness at the hearing. I would welcome an opportunity to work with you and your staff toward formulating federal solutions.

Sincerely,

Betty Wilson

Betty Wilson
President

Mr. **Guarini**. Is this problem prevalent and pervasive through the 50 States? Are you typical or are you atypical?

Ms. **Wilson**. No, we are very typical. Across the country it is the same situation. There are different nuances in different States where the laws are somewhat different, but the situation is really very much the same all over.

Mr. **Guarini**. But the insurance companies can always get around it by making the premium so high that you are unable to meet their demands and thereby indirectly find a way of cancelling the policy?

Ms. **Wilson**. That is exactly right. There's been de facto cancellation because of the price. In my testimony I mentioned the particular vulnerability of volunteer trustees, because when an organization runs bare, there are certain personal liabilities that they take on.

We have had legislation introduced and passed in the State senate which will exempt volunteer trustees from liability, so that's a small amount of relief that we hope to achieve.

Mr. **Guarini**. Is there any sector or captive kind of insurance that nonprofits can form for their own protection?

Ms. **Wilson**. That is an alternative that we would like to see opened up for those for whom it's a possibility. But just as with small business, most nonprofits don't have the kind of cash flow that would be required up front to invest in that. But there are some groupings for which it would be quite appropriate. Some of the Y's have belonged to national captive groupings or self-insurance groupings. However, some of those national groupings have now refused to write in New Jersey, so that those Y's can no longer belong.

Mr. **Guarini**. Now, Mr. Stanton, you didn't get involved with your company in any sector insurance. You just dropped products liability insurance to leave yourself open to defend your own cases directly; is that correct?

Mr. **Stanton**. That's correct. We're bare at this point.

Mr. **Guarini**. And one big judgment could be very fatal to a small company.

Mr. **Stanton**. We do not sleep as well as we used to.

Mr. **Guarini**. Right. And is there any movement within your industry to have a captive insurance company?

Mr. **Stanton**. There have been some proposals, both on an industrywide basis and also a manufacturers' association in our area has made proposals, but so far little has gone on other than rhetoric.

Mr. **Guarini**. All right. Thank you very much.

Chairman **Pickle**. Do you have any questions, Mr. Anthony?

Mr. **Anthony**. I have a couple, Mr. Chairman. Thank you.

Ms. Wilson, what is your response to insurance industry's statement that you did not complain over the last 6 to 7 years about low premiums, and therefore you shouldn't be complaining today that they've had to come back in and catch up?

Ms. **Wilson**. It's certainly true we didn't complain about low premiums. However, I think that all of us recognize that insurance is a cost of doing business, and if there had been a reasonable rate of increase, people would have just looked at it and said it's a cost of doing business.

We are told that a 5 percent increase would have been reasonable. With a 5- or 10-percent increase, there would not have been a peep from any of us. Or, as you suggested to one of the industry people this morning, instead of trying to correct their problem all in 1 year, maybe they could have phased it in. I think that anything along those lines would have been far more reasonable. But the suddenness of it and the magnitude of it is just not acceptable.

Mr. **Anthony**. So if I hear what you're saying, it's that there just appeared to be a total disregard for the fact that many small businesses—in your case, nonprofits—were going to be priced out of the market, as Mr. Stanton was. So you have a different case of nonavailiability, nonavailability due to a higher price.

Ms. **Wilson**. That is correct.

Mr. **Anthony**. And had the insurance industry listened to the warnings in 1982 that were given to them, then they could have started getting their house in order. Then you would have been able to absorb it, as you state, you would have been willing to do that. But now they come in and basically say you either take it or you go bare.

Ms. **Wilson**. That's right.

Mr. **Anthony**. So it appears to me from a Federal level, that the insurance industry just had a total disregard of whether or not they had any responsibility to small business. Because large business, by and large, can figure out how to do it. They either self-insure and pass the cost on through much easier. When we look at this, we really find that the people who are coming in and complaining truly are the small businesses. That large premium increase in any one year probably is much more than their profitability during that 1 year.

So I think you have made a strong case. But if I also understand your testimony, you don't take the position that it's totally a state problem. You think that the federal government does have some oversight and should involve itself, if nothing more than on an intelligence, fact-gathering basis. Then the Federal Government, using those facts, may try to encourage some uniform standards among the States, so that the States can do a better job.

Ms. **Wilson**. That's a very fair statement. Yes, I'd agree with that.

Mr. **Anthony**. Mr. Stanton, as a small businessman, would you encourage any Federal involvement, or do you think it ought to be just totally left up to the States?

Mr. **Stanton**. I would encourage Federal involvement, especially from the area of Federal products liability reform. I would prefer to see the issue of cancellation of insurance dealt with on a statewide basis.

Mr. **Anthony**. Mr. Motley, you have outlined several things that NFIB supports as far as tort reform. Would you be willing to tie those tort reforms to a definite reaction on the other side, or do you just want to see what happens in the marketplace if those tort reforms are put in place?

In other words, we accept your arguments, we put tort reform in place, and then we sit back and watch what happens. It appears to me that if we do that, we should be saying we should get something for that on the other side, if they're saying that is where the big problem is.

So what is your response to that? Could you identify who would get the premium reduction, if anybody; what lines get a premium reduction, or what additional lines of insurance would be made available if we were to go into tort reform?

Mr. MOTLEY. Congressman, we believe that it's a multifaceted problem and therefore has many answers to it. Part of the answer is tort reform. The other part of the answer is the Federal Government getting back into it again at some level, and we're suggesting certain areas that the Federal Government can look at, such as McCarran-Ferguson, such as allowing the FTC to get back into taking a look at the insurance industry again.

When we asked the ISO if there would be a drop in rates if tort reform were passed, the answer was no. They said that there would probably be an increase in availability, and rates would begin to ratchet down over a period of time.

Mr. ANTHONY. Well, if that's being true, then what is the public policy goal that we're trying to achieve: to lower premiums or to go into tort reform?

Mr. MOTLEY. Well, I think to keep rates from going up any farther, and also to make certain that lines of insurance which are not now available, because the insurance community cannot judge the risk involved, available once again, such as toxic waste dumps, toxic waste carriers. Some people in the transportation industry, you cannot get an insurance policy. They're not writing those insurance policies today, and they're not writing them because they have no idea of what the risk involved is.

Mr. ANTHONY. Well, do you think that there is an opportunity here for additional Government insurance? I can show you a list as long as your arm where we have, because of public policy, decided to get into the insurance business. Some would say it may be subsidization of an industry, but is there an overriding public policy that maybe the Federal Government ought to take a look at the insurance of the environmental sector?

Mr. MOTLEY. I think that the Government should take a look at it. As far as an NFIB position on that is concerned, you know how we establish positions is by polling the membership, and that's a question that we're polling right now. So I'll have an answer for you as to where we are in maybe about 4 or 5 weeks. But you certainly should take a look at it.

Mr. ANTHONY. Mr. Chairman, I'd just like to leave Mr. Motley with one last challenge.

If you would take a copy of Mr. Mark Peterson's testimony and look through it, there are some interesting things in there. On page 3, he says:

> After adjusting for inflation, the median or 50th percentile jury award remained almost constant in both Cook County and San Francisco, less than $20,000—

We're talking $20,000 now for the median—

> For both decades of the 1960's and the 1970's.

And then he goes on further to bring it current, and he's basically saying that most jury awards still remained modest. He's only talking about two models, but assuming that those two models would have some relevance throughout the country, seems to be conflicting evidence as to whether or not the jury awards have really exploded like some others are saying. Could you provide us some details?

Mr. MOTLEY. Mr. Anthony, I think, you know, that there is some validity to that, because that really is the reason that when we asked the ISO if rates would decline, they said no, because in the total picture of all of the awards made, the big ones don't have that much impact. What the big ones are doing is scaring off the insurance companies from writing certain lines of insurance or, you know, kicking up premiums to the point where people in the marketplace are not going to seek that type of insurance any longer.

Mr. ANTHONY. Well, I understand that. But I hope we're not catching the insurance industry in a bait-and-switch-type situation. It's my understanding that there are only 400 judgments throughout the country that exceed $1 million. When you say 400 cases, that doesn't sound too large when you hear all these people coming and talking about what a great litigious society we are.

But anyway, it does concern me. So any information you can get out of your association would be worthwhile, and I thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. McGrath, do you have any questions?

Mr. MCGRATH. No. Thank you, Mr. Chairman.

Chairman PICKLE. Well, I thank you, gentlemen. It's been a long day, but we appreciate your testimony.

Now we would ask the last panel to come forward: Dr. James E. Davis, Dr. Leslie W. Seldin, Mr. Jack Owen, and Mr. Carl Blomquist.

Dr. James Davis is the speaker for the house of delegates of the American Medical Association.

Dr. Leslie Seldin is a member of the Council on Insurance of the American Dental Association.

Jack Owen, who is a frequent testifier here, is the executive vice president of the American Hospital Association.

And Mr. Carl Blomquist is the chief executive officer, Mutual Protection Trust, Cooperative of American Physicians from Los Angeles.

We will ask Dr. Davis to proceed first, and I express my regrets because I know you have a flight this afternoon. I hope you can still make it. It just happened that your panel was the last one, and I was hoping it would be called sooner. I'm sorry, but I do appreciate your waiting, and we'd be pleased to hear from you now.

STATEMENT OF JAMES E. DAVIS, M.D., SPEAKER OF THE HOUSE OF DELEGATES, AMERICAN MEDICAL ASSOCIATION, ACCOMPANIED BY CHRISTOPHER A. DAMON, DEPARTMENT OF FEDERAL LEGISLATION, DIVISION OF LEGISLATIVE ACTIVITIES

Dr. DAVIS. Thank you, Mr. Chairman, for your consideration and members of the committee.

My names is James E. Davis, M.D. I'm a surgeon in Durham, NC, and I serve as speaker of the house of delegates of the American Medical Association.

With me today is Mr. Christopher Damon of the department of Federal legislation of the AMA.

Mr. Chairman, since our statement is a part of the permanent record and since it appears at this late hour you've already heard a great deal about the professional liability crisis, I will be brief.

It gives me no pleasure that the problems which for a long time have plagued physicians, and therefore their patients, high premiums and limited availability of insurance, are now plaguing businesses, municipalities, and virtually every sector of the economy.

I would like to talk to you this afternoon about the problem as I have seen it from three different vantage points. In speaking to you as a representative of the American Medical Association, I am speaking for hundreds of thousands of physicians in every type of practice across this Nation, but my views have been focused and strengthened by two other hats I've worn.

As a practicing surgeon, I have cared for patients for many years and have experienced a worrisome change in the doctor/patient relationship because of the liability climate. I also serve as president of a physician-owned, nonprofit insurance company.

Let me review very briefly some fundamental conclusions gained from that experience.

First, there is a liability crisis, undoubtedly. This crisis affects doctors by forcing legal issues into medical practice, influencing medical decisions, changing practice patterns—and these changes are usually to the detriment of the public—by influencing physicians to early retirement, literally forcing them out of their profession whether they are actually sued or not, because of the expense and psychological pressures. Physicians are buffeted by dramatic increases in premiums, some 44.8 percent in the last 2 years alone on average.

In New York and especially on Long Island, a neurosurgeon will pay $100,000 in premiums for only $1 million coverage.

This crisis affects patients. Perhaps their preferred doctor has changed or limited his or her practice as a third of the obstetricians in Florida or 50 percent of the orthopedic surgeons nationwide.

Clearly the costs of liability premiums are passed on to patients, as well as the cost of so-called defensive medicine, which is defined as objective validation of clinical judgment, in case physicians find themselves in a courtroom. And beneficial, high-risk procedures might be avoided or even not introduced, which adds to time and cost for patients.

Mr. Chairman, this crisis affects the Nation's pocketbook. Costs of medical professional liability are estimated to be $11 to $13 billion per year of which the Federal Government pays a significant portion.

Recognizing all of this, physicians themselves have tried to solve the problem by streamlining insurance operations, through development of prompt settlements in deserving cases, stout defenses of others, and by producing risk management programs to reduce liability or its appearance. For after all, 70 percent of cases filed have no merit, but are truly expensive to defend.

Going a step further, physicians themselves form their own insurance companies. If the problem was in the insurance industry, either in profiteering or poor management, we reasoned that physicians could solve it by forming nonprofit companies. Unfortunately, Mr. Chairman, our experience has paralleled that of the commercial companies. Patient compensation funds and joint underwriting associations run by the Government have had the same experience also.

Based on this, physicians in this country have reached a conclusion that seems inescapable. Under current conditions, it is futile to expect a solution to the liability problem through the insurance mechanism alone. We have fine tuned the insurance system as far as we can, and we still have a problem.

We believe that to achieve insurance stability, predictability, and affordability, there has to be a change in the tort system. The current system is slow, inequitable, expensive, and has a lottery air to it.

Mr. Chairman, we endorse an approach of Federal incentives to States to assist them in adopting tort reforms, as well as improvements in risk management and medical discipline. H.R. 3865, introduced by Representatives Norman Lent and J. Roy Rowland, would strike the right balance in giving Federal leadership on a problem of Federal proportions while leaving States with the responsibility for final actions. It would bring rationality and predictability into our liability system without denying the right of any patient to seek fair compensation. Indeed, its provisions could well be applied to general liability problems as well.

In brief, the bill would encourage and reward States to enact certain tort reforms and physician disciplinary procedures, these being periodic payments on large awards, offsetting awards by amounts received from collateral sources, capping noneconomic damages, limiting but not abolishing attorney contingency fees, and physician self-discipline and mandatory risk management and reporting provisions.

Our actuaries predict that this legislation would save 28 percent in physician premiums alone. Enactment of this legislation, in our view, would produce a more favorable climate in which to compensate injured patients, improve patient care, and preserve a healthy patient/physician relationship.

Mr. Chairman, thank you for the opportunity of being here. I look forward to addressing questions.

[The prepared statement follows:]

STATEMENT

of the

AMERICAN MEDICAL ASSOCIATION

to the

Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives

Presented by

James E. Davis, M.D.

RE: The Crisis in Medical Professional Liability

March 13, 1986

Mr. Chairman and Members of the Subcommittee:

My name is James E. Davis, M.D. I am Speaker of the House of Delegates of the American Medical Association. With me today is Christopher A. Damon of the AMA's Department of Federal Legislation. The American Medical Association appreciates the invitation to testify on the medical professional liability crisis in the context of the overall liability situation in the United States today. We commend you, Mr. Chairman, and this Subcommittee for holding these hearings to highlight an increasingly important national problem.

Although our testimony today will focus on the crisis facing the medical profession, we are acutely aware that medical professional liability represents only one part of an overall liability problem in this country. Our situation is unique, however, in that this is not the first time that medicine has had a professional liability crisis. Moreover, we have been experiencing an increasingly negative litigation climate for over a decade.

The problem, ironically in a sense, stems from our desire to care for injured persons and to see justice done. Those of us in the profession of medicine, with its tradition of compassionate care for others, can readily identify with these motivations. The fundamental generosity and compassion of the American people have been reflected in recent years in a broadening of traditional negligence theory in an effort to compensate those injured even in cases where application of traditional negligence principles may not have resulted in damages.

Physicians are in favor of proper compensation and justice for those who are injured due to the negligent or wrongful conduct of another. This nation's civil tort system has been the channel through which justice and compensation have been obtained. We believe that the basic framework of our tort liability system has in the past worked reasonably well. It is not working well today. It has become an erratic, expensive and unfair system.

Our tort system has historically had its limits. It is not designed to compensate all maloccurrences. It requires that some named individual or entity be found responsible for the injury in order to justify compensation. "Acts of God" or injuries that are entirely the fault of the plaintiff are not intended to be compensable through the civil tort process. The system, clearly, is not intended to provide compensation for all injuries or maloccurrences.

In addition to the general expansion of negligence and other theories to provide greater degrees of injury compensation, the field of medicine has the added burden of meeting increasingly high expectations from patients and their families. No one can deny the astonishing progress we have made in this country in medical diagnosis and treatment with the concomitant decreases in infant mortality, increases in life expectancy and improvement in the quality of life of many through appropriate medical intervention. By every measure, the quality of medicine in this country has never been greater. However, an unfortunate side effect of these enormously beneficial developments is an increased level of unrealistic expectations by patients. Medicine is not an exact science and a desired outcome cannot always be obtained -- even when everything is done appropriately. This nation's more than 400,000 practicing physicians have the challenge of meeting the ever-increasing medical care expectations of 240 million Americans.

Physicians are on the cutting edge of the liability problem facing the nation. New legislative solutions developed could have initial application in the field of medical professional liability. Problems that we have already experienced with increasing severity are now being faced by others. It is our view that adoption of the legislative proposals which we advocate will lead the way towards efforts to prevent the general liability problem from worsening. Medicine, however, cannot wait for all the problems of liability to be addressed. We need action now and so we urge the Congress to deal promptly and effectively with the liability issue.

THE CURRENT MEDICAL PROFESSIONAL LIABILITY CRISIS

I would like to present this Subcommittee with certain facts illustrating the gravity of the current medical professional liability crisis:

- the number of malpractice claims brought against physicians in 1983 is roughly double the number of claims brought in the mid-1970s.
- since the mid-1970s, the size of the average award against physicians has tripled, resulting in an average verdict of $338,463 in 1984. The number of million dollar judgments per year has more than tripled since 1980.
- Premiums for physicians' professional liability insurance continue to rise dramatically. A few weeks ago in Massachusetts, physicians experienced an average 62% hike in their malpractice insurance rates. In Maryland, obstetricians saw their malpractice insurance rates increase by 130% last summer. For all physicians, premiums have increased by 44.8% in the last two years alone and by 236% in the last decade. Average premiums for New York physicians have risen by 312% since 1975. Neurosurgeons in New York face premiums of over $100,000 a year.
- Injured patients on average receive less than 30¢ of every premium dollar paid by physicians for professional liability insurance.
- Because of the increasing numbers of claims and higher premiums, physicians are reacting by:
    - . . . retiring early;
    - . . . discontinuing medical practice;
    - . . . restricting their practice to low-risk procedures;
    - . . . choosing lower risk specialties for practice;
    - . . . avoiding practice in localities where large numbers of medical professional liability suits are filed.
- A recent survey by the American College of Obstetricians and Gynecologists found that the economic pressures of malpractice suits have forced 12.3 percent of those surveyed

to drop obstetrics practice. Those surveyed reported an average annual premium of more than $20,000. In Florida, obstetricians and gynecologists pay as much as $92,500 per year in malpractice premiums.

- The Florida Medical Association has estimated that from 25% to one-third of that state's approximately 850 obstetricians have stopped delivering babies because of the risk of lawsuits and the high cost of liability insurance. In Maryland, an estimated 12% of obstetricians have stopped delivering babies after the 130% hike in malpractice rates last summer.
- A 1984 American College of Surgeons survey found that concerns over potential medical professional liability suits have influenced 38% of responding surgeons (50% of orthopedic surgeons) to refer more cases or to refuse to accept cases.
- Physicians are also reacting to the professional liability crisis by practicing "defensive medicine", a practice which includes ordering additional tests and procedures primarily in anticipation of a possible lawsuit. Studies indicate that 70% of physicians surveyed practice some form of defensive medicine. While some "defensive medicine" is good, much of it is not, and it is expensive.
- In 1983, about half (45%) of persons 65 and over lived in seven states. California and New York had over two million each, and Florida, Illinois, Ohio, Pennsylvania and Texas each had over one million. The professional liability problems in these states have been well publicized in recent years. Hence, a large proportion of Medicare beneficiaries may already be feeling the impact of professional liability in terms of higher health care costs.

COSTS OF PROFESSIONAL LIABILITY

The professional liability crisis not only is having a detrimental impact on physician practices and patient access to quality medical care, it also represents a significant and growing segment of the nation's health care bill. The costs of medical professional liability totaled an estimated $11 to 13 billion in 1984. These estimates suggest that costs generated by the current liability system were responsible for between

14.5% and 17.5% of the $75.4 billion spent on physicians' services in the United States in 1984.

It has been estimated that if the reforms advocated by the AMA were adopted, the potential annual savings would be $800 million to $1 billion in premium costs alone. Huge additional savings would be achieved through the reduction of the practice of defensive medicine. The federal government, which pays for nearly 30% of the nation's total health care bill, would realize major savings.

FEDERAL INCENTIVES FOR STATE HEALTH CARE PROFESSIONAL LIABILITY REFORM

An AMA Special Task Force on Professional Liability and Insurance last year gathered data about the professional liability crisis and met with medical, legal and insurance experts. The Task Force's report constituted an action plan containing a series of recommendations in the educational, medical, legal, and legislative fields. With regard to legislation, the Task Force recommended federal incentive legislation to encourage the states to adopt substantive reforms to the tort system in order to alleviate the professional liability pressures while at the same time encouraging greater physician responsibility. This approach is intended to allow states, within general directions provided at the federal level, to develop tort reform proposals designed to meet each state's unique characteristics and needs. Out of these recommendations, an AMA draft bill was developed which formed the basis for H.R. 3865, a bill sponsored by Representatives Norman Lent and J. Roy Rowland and a number of others. A companion bill, S. 1804, is pending in the Senate.

H.R. 3865 - The Federal Incentives for State Health Care Professional Liability Reform Act.

H.R. 3865 would provide federal incentives for states to adopt professional liability reforms. A state would be eligible to receive federal grants if the following tort reforms are adopted by the state and made applicable to cases involving health care malpractice:

1. Mandatory periodic payments for awards of future damages exceeding $100,000.
2. Reductions in awards for compensation received from other sources (eliminating collateral source rule).
3. Limiting awards for non-economic damages to $250,000.
4. Limiting attorneys' fees to 40% of first $50,000 of any award, 33.33% of next $50,000, 25% of next $100,000, and 10% of any further amounts in excess of $200,000.

These reforms are designed to attack the problem of windfalls and would leave the fault concepts and deterrence factors in the system.

In addition, to qualify for grants a state would have to adopt the following reforms:

1. Licensing fees from health care professionals would be allocated exclusively to the state agency responsible for disciplinary actions.
2. Hospitals would be required to have risk management systems.
3. Insurance companies in the state would be required to conduct risk management programs and require physician participation as a condition of maintaining insurance.
4. Insurance companies would be required to make data concerning malpractice awards available to state disciplinary agencies.
5. State law would have to provide for expanded and protected peer review activities by state health professional societies in conjunction with their respective disciplinary boards.

Experience in states which have enacted reforms in their tort systems has shown that reforms such as those called for in H.R. 3865 can reduce unnecessary expenditures related to professional liability claims while providing more rapid compensation for individuals.

Let me briefly examine each of the reforms.

Periodic Payments for Future Damages. Structured settlements with periodic payments for future damages over an injured claimant's lifetime, rather than a lump sum payment, should be required. Periodic payments are less expensive to finance and they assure that financial resources will be available to an injured person over time as needed. H.R. 3865 also provides that payments should end if a patient dies, thus eliminating "windfall" payouts to persons other than the injured person. Cases have been reported where multimillion dollar judgments have been awarded to cover lifetime expenses of parties who die soon after the award is granted. Estimated savings of 6% in professional liability premiums alone could be realized from this reform provision in H.R. 3865.

Elimination of Collateral Source Rule. The collateral source rule prohibits the introduction into evidence of any information about compensation a plaintiff may receive from sources other than the defendant. Therefore, plaintiffs may receive a double, triple or quadruple recovery for the same injury -- one from an insurer or employer or other source, and one from the defendant. H.R. 3865 encourages states to eliminate this rule so that awards would be offset by the collateral source recovery. Amounts spent by the plaintiff to obtain the additional compensation (such as insurance premiums) would be offset against any deduction. Estimated professional liability premiums savings of 8% could be realized from this reform provision in H.R. 3865.

Limit on Non-Economic Damages. Pain and suffering, mental anguish, and loss of consortium are examples of non-economic damages. These damages are impossible to ascertain accurately, can be manipulated by emotion, and are inevitably subject to speculation. They are a primary cause of the grossly distorted awards in professional liability cases. Non-economic damages should be limited. H.R. 3865 would provide incentives for states to limit non-economic damages to $250,000 in health care malpractice cases. Punitive damages would also be subjected to this cap. Estimated professional liability premium savings of 12% could be realized from this reform provision in H.R. 3865.

In this regard, I note, Mr. Chairman, a 1984 opinion poll published by the AMA which found that three of four Americans aged 65 and over believe there should be a limit on awards. Half say that current awards are too high, and only 23% think most suits are justified.

Restriction on Attorneys' Contingent Fees. The American Medical Association does not recommend abolition of the contingency fee system. However, a sliding scale for such fees should be established. Customarily, attorneys accept personal injury cases, as well as professional liability actions, on a contingent fee basis. The attorney may receive from 25% to 50% of any award eventually won. Injured patients on average receive less than 30¢ of every dollar paid by physicians for professional liability insurance. Moreover, two-thirds of claims are settled with no payment. This high rate of non-meritorious claims is in large part due to the contingency fee system. The disproportionate nature of the attorney's contingent fee is compounded by the fact that there is often no relationship between the size of such fee and the degree of complexity of the matter and amount of legal skill and time devoted to the case.

H.R. 3865 would encourage states to enact a sliding scale for such fees, with declining percentages paid to an attorney as the size of the award increases. This would help assure that the appropriate proportion -- i.e., the bulk -- of the award goes as compensation to the injured party, not to the lawyers. At the same time, because of the larger percentage at the lower end of the award scale, lawyers would still be encouraged to accept cases with lower anticipated judgments. This would not, as frequently charged, deny or restrict patient access to proper remedies.

The American Bar Association, in a report on a five-year study that was issued in August, 1984, found that when lawyers reduce the amount of time spent working on a lawsuit, the savings are passed on to clients only if the clients are paying an hourly rate. When lawyers work on a contingent fee, "lawyers are benefiting," not clients, the report said.

Estimated premium savings of 9% could be realized from this reform provision in H.R. 3865.

Other reforms.

The AMA and the medical profession are committed to weeding out incompetence. We do not, however, view incompetent physicians as the cause of the current crisis concerning professional liability. The typical medical professional liability case involves a good physician being sued for the first time. Physician incompetency is an independent problem which we believe we have an obligation to address. Physician competency and discipline can be improved, but we need the tools. The process is already in place to conduct appropriate disciplinary activities, as seen in existing hospital peer review and quality assurance programs. However, greater resources are needed and anti-trust protection needs to be conferred.

Strengthening state licensing boards. Most states have legislation which gives state health professional licensing boards effective investigative and disciplinary powers. However, these boards must have adequate resources to fulfill their functions. H.R. 3865 would require, as a condition of receipt of the federal grants established in the bill, (1) that states provide that licensing fees from health care professionals would be allocated to the state agency responsible for disciplinary actions and (2) that insurance companies be required to make data concerning malpractice awards available to state disciplinary agencies.

Risk Management and Peer Review. There is no evidence that the increase in the number of professional liability claims and the severity of awards are related to a decline in the quality of medical care in this country. To the contrary, the evidence is that the quality of care and skill of physicians have never been higher.

However, negligence does occur, and effective risk management and peer review can reduce it. H.R. 3865 would encourage states to require hospitals to have risk management systems and to require insurance companies in the state to conduct risk management programs and require physician participation as a condition of maintaining insurance.

In addition, state law would have to provide for expanded peer review activities by state medical societies. This provision in H.R. 3865 seeks to strengthen public and private efforts aimed at detection and discipline of physicians found to violate professional standards. The bill encourages states to provide their medical disciplinary boards with the authority to enter into agreements with the state and county medical societies to permit them to review any malpractice action, complaint or other information concerning the practice patterns of any physician. Any such agreement between the medical board and medical society would not be grounds for any civil or criminal action under the antitrust laws of the state or under federal antitrust laws. This is important, since in the past when medical societies have attempted to engage in peer review and discipline they have at times been subjected to lawsuits and liability for treble damages. Appropriate physician self-policing activities need to be protected and encouraged.

CONCLUSION

In closing, Mr. Chairman, I again commend you for your active interest in this critical issue as shown in your holding of this hearing.

The AMA strongly supports prompt passage of H.R. 3865. We believe that its enactment will assist in establishing a more rational professional liability compensation system that will achieve substantial savings to the health care system (including the federal and state governments) while maintaining patient access to high quality health care.

At this time I would be happy to answer questions from the Subcommittee.

Chairman PICKLE. Thank you very much, Dr. Davis, for your statement. Now we will ask Mr. Seldin if he will proceed.

STATEMENT OF LESLIE W. SELDIN, D.D.S., VICE CHAIRMAN, COUNCIL ON INSURANCE, AMERICAN DENTAL ASSOCIATION

Dr. SELDIN. Thank you, Mr. Chairman.

My formal statement has been submitted for the record. I would like to summarize some of our thinking more informally for you.

My name is Leslie W. Seldin. I am a practicing general dentist in New York . I am president-elect of the Dental Society of the State of New York and vice chairman of the Council on Insurance for the American Dental Association.

I am here today representing 140,000 dentists who are gravely concerned about the malpractice problem they are facing. No matter where we meet, no matter where we find each other, the No. 1 topic of conversation is malpractice insurance.

It is not only the escalating cost of that malpractice insurance, but the availability of that insurance that is of concern to our members.

We have reached a period in history today where advances in medical science are unbelievable. We are doing things we never dreamed we would be able to do when we were in dental school a number of years ago.

Instead of enjoying this opportunity to provide this kind of care, we are faced with apprehension in this litigious society in which we live. There is an aura of infallibility about what we do, the public's perception that we can do anything and be successful at it. As a result, the standards that are applied to our abilities and acceptability of our care in the courtroom has been raised significantly.

As a result of these problems, we now have seen a very exceptional increase in the frequency of cases that have been brought forth and an increase in the severity of the claims and awards that have been made.

In 1978, dental cases across this country averaged 6.8 cases per 100 dentists. In the latest full year figures, 1983, it has risen to over 9.2 per 100 dentists. And we anticipate in the years 1984 and 1985 1 out of every 10 of our colleagues will be faced with a malpractice claim.

The average paid out awards in 1978 for the dental profession was figured at $6,600. By 1983 it has soared above $33,000 per case and is escalating rapidly.

So our premium levels have gone up. In 1985 the American Dental Association membership faced a premium increase of 300 percent. And just this past month we were faced with another 100-percent increase. If you multiply that out, we have felt a 600-percent increase in our malpractice premiums within the last 14 months.

While the gross premium levels for dentists are not exorbitant at this point, the predictions indicate that the upswing has not ended and we anticipate greater increases in the future.

Oral surgeons in New York City who, in 1975, paid $150 a year for $1 million coverage, are now paying $66,000 a year for that same coverage. And in areas of Florida, at this point in time——

Chairman PICKLE. What is that comparison? What were they paying a year?

Dr. SELDIN. $150 in 1975, sir, and now we are being charged $66,000.

Chairman PICKLE. Good God.

Dr. SELDIN. In areas of Florida, this year, oral surgeons will be asked to pay $94,000 for $1 million coverage.

Chairman PICKLE. Dr. Davis, has your cost gone up similarly or even more?

Dr. DAVIS. Even more, yes, sir. We started at a higher base. The percentage is larger, the rate increase, but we are reaching the same high limit, sir.

Dr. SELDIN. The insurance industry seems to have been unable to predict the precipitous escalation which they found and coupled with the decrease in the interest income in the past few years, dentists have been faced with not only the increasing premiums, but a contracting marketplace. We have minimal availability for coverage that we so badly need.

In New York State alone, in 1985, one malpractice carrier was bankrupted. One was forced into reorganization. One is under attack by the attorney general of the State for illegally marketing to the dental profession. One has withdrawn, two have declared moratoriums on new business.

We are left with one major carrier willing to offer New York State dentists, in general, a program of insurance liability.

In some States across this country, only one carrier is available. In this marketplace, we are crossing our fingers and hoping that one carrier will continue to be there long enough for what is supposed to be cyclical turns around and loosens the marketplace.

As a practicing dentist who has had the opportunity to participate in courtroom proceedings—thank God not as a defendant—work with insurance carriers at every level, it is obvious the insurance carriers are fearful of the ability of the litigation process to deal with the complex health care problem. They have had to settle cases due to the unpredictability of the juries and the awards that they would anticipate.

Judges, juries, attorneys are all well-intentioned and honest, but they cannot understand the intricacies of dental or medical negligence cases. And we espouse the concept of arbitration panels so that laymen and professionals can work together with expertise to understand better what has now become so complex.

We are totally supportive of the system of justice. It has served us well. But maybe the complexities of our society have created a need for adjustment, amendment, or change in this litigation process.

We have analyzed the crisis. It is now reaching every aspect of our lives and everybody is doing their job legally, lawyers, insurance carriers, health practitioners and the public all do what they deem appropriate and there is no villain in the piece. But the system must change to halt this viscous cycle which is feeding on itself.

Increased premiums and decreased availability is the symptom, not the cause. Some agency that stands above and apart must help out and intervene. We applaud the committee's ability and willingness to address the situation. We recommend reforms in the tort system. Liability laws are in the purview, for the most part, of State governments which need Federal encouragement, incentives, or penalties to pass litigation changes that will be helpful to the program.

We might suggest to you legally constituted arbitration panels, structured awards, elimination of collateral sources, limits on contingency fees for attorneys, limits on noneconomic losses, guarantee of availability of coverage to our membership. We are doing our jobs as best we can by teaching our membership everything we can about risk management. Our president, Dr. Kobren, has sent a letter to every State encouraging them to help out and cooperate in strengthening the peer review procedures, to cooperate with State governments, and the panels which govern the negligence crisis.

We do not wish to alter the principles that every man must be entitled to his day in court. It is only through creative tort reform that meaningful controls can be instituted and we are pleased that Government leaders are going to take it upon themselves to investigate it.

We pledge our support. We will cooperate in every way possible. We will be happy to answer any questions you may have.

Thank you.

[The prepared statement follows:]

STATEMENT OF LESLIE W. SELDIN, D.D.S., VICE CHAIRMAN, COUNCIL ON INSURANCE, AMERICAN DENTAL ASSOCIATION

My name is Leslie W. Seldin. I am a member of the American Dental Association Council on Insurance. I am a practicing dentist from New York City, and I, like many members of my profession, am deeply concerned with the escalating costs of liability insurance premiums and the potential fear of not having any liability coverage available at any cost.

That is why, Mr. Chairman, I commend you for your leadership in holding these needed hearings to facilitate discussions on the nature and causes of the liability problem as well as possible parameters for solutions to the present "crisis".

The dental profession supports a fair resolution of claims, which adequately and appropriately compensates injuries. Certainly injuries have occurred through the negligence or improper action of health professionals and others. However, our concern is that the present litigation system is not working fairly or efficiently due to excessive filing of claims, laborious litigation, large awards, and therefore, increasing liability premiums for dentists and others seeking coverage. Primarily because of these factors, liability claims will be filed against almost one out of every ten dentists this year. The average dental malpractice award has increased over five fold since 1978.

More important, this increase in the frequency and severity of claims is projected to continue--resulting in percentage increases in insurance premiums that are staggering. Last year dental liability premiums went up 300 percent on the average, and this year premiums are expected to double. If no action is taken, liability premiums will at least double every four or five years. Dentists, who utilize anesthesia outside the hospital, are expected to be paying as much as $40,000 and even more in liability insurance premiums in some areas such as New York City.

These astronomical increases in liability insurance rates are the result of many converging social, economic, and legal trends; however, most result from our present expensive, inefficient and unpredictable litigation system. Litigation costs now account for a substantial part of professional liability costs, resulting in a much lesser amount going directly to injured patients.

Undeniably we live in an increasingly litigious society. The readiness to litigate has been exacerbated by the breakdown in health care practitioner/patient relationships. Technological advances have unrealistically heightened the expectations of patients. Even the mere threat of litigation has resulted in dentists and other health professionals engaging in defensive practices that contribute greatly to the nation's health bill.

These factors are but a few of the innumerable causes that add to the costs of health care. Of course, increased liability premiums are added on directly for the provision of dental care. Additionally, defensive practices actually account for even more of the overall costs. Both of these concerns impact on dental services provided in the private sector as well as federal programs such as Medicare.

Mr. Chairman, the present litigation system is in need of major reform. The Association strongly believes that the best opportunity for significant reform is at the state government level. However, at the same time, we believe that the federal government does have an appropriate role of using financial incentives and/or sanctions to induce the respective states to act.

In any possible action undertaken at the federal level, the Association would recommend that sufficient flexibility would be preserved for the states either in the form of federal guidelines or an optional list of tort reforms to be adopted. Such flexibility would allow the states some input into reforming their own tort laws, and would also enable the states to address their own liability problems with specific reforms. Such an optional list could include reforms such as the use of arbitration panels, shorter statutes of limitation, structured payments, elimination of the collateral source rule, a cap or limit on non-economic damages, reasonable limits on contingency fees, and even alternative liability approaches.

An alternative approach that the Association is particularly interested in exploring is a mechanism for mandatory, non-binding arbitration which would be applied to smaller claims with the hope of reducing frivolous suits. In essence, if a plaintiff received an adverse decision by an arbitration panel and still chose to litigate the case in court, he would pay the defense costs if he did not prevail.

Mr. Chairman, we are all confused somewhat by these dramatic changes in liability insurance premiums. We hear of "long tail" effects, claims made versus occurrences policies, the short list of liability insurance underwriters, and the missed economic projections of the insurance industry. However, the bottomline is, and everyone understands this, that the days of inexpensive dental liability coverage are gone forever.

Like the present litigation process, the insurance companies are also part of the present "crisis". We hope that there will be a careful review of insurers' practices in such areas as projecting premiums, use of experience rating, implementation of a risk management requirement as a condition for coverage, and making determinations to settle rather than litigate claims.

We believe there are constructive changes in liability insurance procedures which can be helpful in alleviating the current liability crisis.

For instance, we would recommend the possible establishment of various classes of insurance rates based on a health care professional's record on malpractice judgments and/or arbitration awards, and on participation in ongoing risk management programs. For health care professionals with multiple judgments against them, there would be escalating increases in insurance rates. If such incidents continued to occur, this information could be forwarded to the state licensing board to investigate whether or not to reprimand, suspend, or revoke the license of the health care practitioner in question. On the other hand, if practitioners maintained a good record and attended risk management programs on a periodic basis, then they could receive premium credits.

Mr. Chairman, we all realize that negligent practices do occur in dentistry as well as in other health professions or any other endeavor. Admittedly much more can be done by state disciplinary boards, peer review committees, and risk management programs to insure quality of care and to prevent or at least minimize incidences of negligent practice.

Over the years the dental profession has participated in the abovementioned activities but, in light of this crisis, we are re-dedicating ourselves to disciplining negligent practices and to rendering the highest quality dental care services possible.

In this regard, the Association President Dr. Abraham Kobren is sending this letter to all constituent (state) and component (local) dental societies urging them to strengthen the disciplinary functions of their states' licensing boards, peer review committees, and other mechanisms to assure quality of care. Dr. Kobren, in his letter, also urged state and local dental societies to work with their respective legislatures on needed liability reforms including limited immunity statutes for those who serve on licensing boards and peer review committees.

Actually the Association already has begun many of these activities, but this will provide a fresh opportunity to examine where we are and where we need to go. For example, the Association recently revitalized a comprehensive risk management program. Attached is a partial listing of ongoing ADA risk management activities. Such programs should be helpful not only in raising the awareness of dentists to liability problems and their prevention, but also will result in the delivery of quality dental care services to the public.

Mr. Chairman, we pledge to do our best in educating dentists and the public about the liability problem and a range of possible solutions. However, as you are aware, this will simply not be enough in light of the magnitude of the liability crisis. The liability problem is reaching such dimensions that it will require the help of both the federal and state governments, health providers, insurers, the legal profession and other interested parties to reform a litigation system that is ineffective, confusing, and not working efficiently or fairly for interested parties, especially injured patients.

This is not just a dentist problem nor only a physician problem, it is increasingly a pervasive problem that adversely affects all segments of our society -- state and municipal governments, corporations, small businesses, bus drivers, day care centers, bartenders, and even ministers.

Mr. Chairman, we would urge members of this committee to explore the common reforms of the numerous legislative proposals on product liability, professional liability, and general liability reform. It may be possible to coordinate efforts and develop a broader approach for resolving the liability crisis. To this end, the Association has recently joined the American Tort Reform Association that is coordinating the activities of over 200 organizations in seeking broad based solutions to overall liability reform.

In conclusion, the American Dental Association strongly believes that there is a definite liability problem that has multifaceted causes, and requires a number of possible solutions. The Association appreciates the opportunity to present its views, and we look forward to working with you and your staff in promoting workable solutions that will not only resolve a rapidly worsening situation for dentists and other health care professionals, but will also help curb increasing costs to consumers for dental care and other services.

Chairman PICKLE. Thank you very much, Dr. Seldin. We appreciate your testimony.

Now, Mr. Owen, if you will proceed, sir.

STATEMENT OF JACK W. OWEN, EXECUTIVE VICE PRESIDENT, AMERICAN HOSPITAL ASSOCIATION

Mr. OWEN. Thank you, Mr. Chairman.

My name is Jack Owen. I represent the American Hospital Association. I have a statement, submitted for the record, which gives a lot of statistics on what is happening in the health care field.

I would only call your attention to the last one—the last page—which shows from January 1985 to November 1985 that the cost of professional liability insurance has gone up about $25 per bed per hospital. And as you know, with the problems we are having, with Medicare budgets and so forth, this is a difficult situation.

I am here really, in two capacities, first to represent the American Hospital Association but second, as Congressman Guarini probably remembers, back in 1975 when I was president of the New Jersey Hospital Association, we had a crisis there in which the insurance companies walked out and left our hospitals without any insurance whatsoever. At that time, it was my job to establish a captive insurance company called the Health Care Insurance Exchange, which is a license reciprocal operating in New Jersey with a stock company, Princeton Insurance Co., which is now covering 95 out of the 100 hospitals in the State, some 5,700 doctors, most of the dentists, all of the podiatrists, and over 3,000 nurses.

So I do have some idea, a little bit, about the insurance side of it, as well as the hospital side of it. And I would be happy to answer any questions about that.

The company has done very well. Our rates have been kept low and I think there are some things we can learn by having a captive company in a situation where we can watch the way the claims are being handled.

The concern that we have, with the problem of liability, which you have heard from the two doctors already, extends to each and every hospital coverage of physicians who are on staff, coverage of medical staff, coverage of our own nonprofessional and other professional staff, as well as the hospital itself. Prices have been going up, as you have heard.

The crisis back in 1975, that we went through, was primarily for primary insurance. Companies were pulling out and we could not find coverage. The crisis today stems primarily from the reinsurance market. And as an insurance company, trying to find reinsurance either in the London market or in the domestic market is almost impossible. If your company does not show that it has a profitable bottom line, is not doing things to hold down claims, then the reinsurance market dries up and most of these insurance companies then want to get rid of all the risks that they can.

One of the things that I would like to point out is that yesterday Congressman Ron Wyden introduced a bill called the Health Quality Assurance Act of 1986, which the American Medical Association, ourselves, and the AARP endorsed in concept. And this, I think, is the first step towards doing something about the malpractice problem.

This bill really calls for looking at licensed physicians and what boards of medical examiners do with physicians, and when a physician loses his license in one State, how do we keep track of that physician who moves to another State?

The problem that I see frequently happening, as we look at tort reform, and we look at trying to change the system, is that the whole issue gets clouded by lawyers frequently saying that the only problem with malpractice insurance is the bad doctors. If you remove all the bad doctors, there would not be a problem. That is not true and that is not going to change the problem or the crisis that we have.

What this bill would do is put that issue aside, because we would be able to keep track of physicians who had problems and who were not licensed properly. But that is not going to solve the malpractice crisis that you have heard about from these witnesses—the physician and the dentist today.

But it will uncloud some of the issues.

There are several things that we think could be done. I expect they have been said to you many times before, but I think they bear repeating, at least one more time. And that is that if the Federal Government could urge the States to enact some kind of legislation which would help to solve the problem, it's probably the best way to approach it. I am not sure that the Federal Government should be looking at insurance companies the way that insurance departments are. That may be something in the future that the Federal Government wants to do.

But right now it is a State function and I——

Chairman PICKLE. Mr. Owen, what would we ask the States to do?

Mr. OWEN. I think a couple of things. The State ought to set a cap on noneconomic damages, the pain and suffering. Not the economic damages, actual damages, but pain and suffering. This is where the big dollar awards are going forward. And I think there ought to be a limit on that.

I think we ought to get rid of the collateral source rule because that has been a problem for a long time and there is no reason for a plaintiff to collect once or twice or three times on the same issue.

I think there should be structured awards in each State. When somebody is hurt or damaged, that person should be taken care of and they should have their expenses paid. But it does not mean that if they die it becomes an estate problem for the family that is left.

And then, lastly, I think if we could abolish the joint and several liability rule which allows the collection of full amount of damages from any defendant no matter how much at fault, it would be helpful because what is happening is plaintiffs are going to the defendant with the most money.

And I think there is a way to do it. If the Federal Government said to a State unless you do something in this kind of reform, there will not be matching moneys from Medicaid, highway department, or what have you, it would probably get some attention from the States.

I might add, however, that there are a number of States—we just did a survey and there are over 30 States that have on their legislative calender either action to make some kind of tort reform or to do something that might change the way the insurance industry operates.

The other thing might be, also, to keep in mind that any State, to our knowledge, so far that has tried to change or set a limit on the amount of damages, has found that it has been ruled unconstitutional in the long run.

However, on the pain and suffering, the collateral source rule, and on the structured settlement, all of those have met the test of constitutionality in almost every State, so far. So there are some things that can be done.

Thank you, Mr. Chairman.

[The prepared statement follows:]

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STATEMENT OF THE AMERICAN HOSPITAL ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
ON
MEDICAL MALPRACTICE LIABILITY

13 MARCH 1986

INTRODUCTION

Mr. Chairman, I am Jack W. Owen, Executive Vice President of the American Hospital Association and Director of the Washington Office. On behalf of the 6100 institutional and 38,000 personal members of the Association, I am pleased to be here to discuss the medical insurance liability situation in the context of the overall liability crisis as it exists today.

BACKGROUND

From 1973 to 1975, hospitals and physicians experienced a crisis in the availability and cost of professional liability (malpractice) insurance. The situation climaxed at that time because of the combined effects of the following sequence of events:

- The frequency of malpractice claims filed multiplied to the extent that predictions of risk areas and future losses became unreliable and therefore useless.

- The total amount of dollar awards to plaintiffs increased as a partial function of the increasing number of claims and inflation.

- A large number of malpractice insurers suddenly withdrew from the market, due to unpredictable future losses and the resulting difficulties in pricing malpractice coverage.

- Exorbitant malpractice insurance premium increases were imposed by those insurers remaining in the market.

Insurers, health care providers, and state governments scrambled to address what were seen as the root causes of the problem. Insurers redesigned their products, as well as their price structures. For example, carriers sought to limit their loss exposure by offering "claims made" coverage (only covering those claims reported while the policy was in effect) instead of "occurrence" coverage (covering all claims, whenever reported, that arise from events that occurred while the policy was in effect). This strategy was intended to improve the predictability of liability for the insurers by reducing the impact of the "long tail" (the delay between an incident of malpractice and the filing of a claim), and transfer more of the risk of financial loss to the hospitals.

In response to these changes in the insurance market, hospitals developed new internal quality assurance and loss prevention procedures to control, if not prevent, circumstances that could result in malpractice claims. Groups of hospitals and groups of physicians, often through their respective associations and societies, formed specialty malpractice insurance companies to assure continued access to insurance. In addition, nearly every state enacted some change in the laws governing malpractice claims.

The most publicized and dramatic event was the enormous rise in the cost of malpractice insurance premiums, which in some cases rose 100%-750% in a single year. Many commercial insurance companies left the market or severely restricted their malpractice writings as the crisis emerged. Some reentered the market later as premiums rose to levels they considered appropriate, and their investment earnings increased as the general economy strengthened.

Following the 1975 crisis, at least 40 hospital-formed insuring organizations and about 50 physician-sponsored companies were formed to cover their constituents' medical malpractice insurance needs. It is estimated by The Wyatt Company that these so called "captive" companies combined now write about 45% of all professional liability insurance.

A large number of hospitals became self-insured to avoid malpractice premium increases. In addition, offshore malpractice insurance arrangements were also established, as well as state operated joint underwriting associations .

One of the hospital-formed insuring organizations started in the late 1970s was the AHA's Health Providers Insurance Corporation (HPIC). It is a reinsurance company that shares in the reinsurance arrangements of many other hospital-formed insurance companies and self-insured hospitals. Reinsurance provides a secondary means of protection against enormous judgments by covering those losses that exceed the policy limits of the primary insurer.

By 1979, the situation had stablized. Although premiums remained quite high, medical liability insurance coverage was generally available. Actually, premiums leveled off as insurers began to rely increasingly on their hefty investment income (thanks to double-digit inflation in those years) to compensate for shortfalls in poor underwriting results. Nevertheless, the average number and dollar amounts of claims continued to increase due to damages brought about by the explosive growth of new medical technology. Therein lies the beginning of a new crisis in the medical malpractice insurance market.

In 1984, signs appeared that indicated the health care field was headed for another malpractice insurance crisis, and by the end of January, 1985, it had arrived. Many medical malpractice insurance and reinsurance companies stopped offering policy renewals, and those that did began raising rates by as much as 200% to 300%, and even more in some circumstances. Some insurers agreed to renew, but in addition to dramatic price increases, announced that the occurrence policy form would no longer be offered .

As insurers currently raise premiums dramatically in an attempt to reverse the underwriting loss pattern of the last several years, others are leaving the market entirely; and many of the remaining insurers are taking selective action against specific lines of business that represent the biggest financial "losers" from their point of view.

Professional liability insurance is a prime target for this line of attack. Although medical malpractice premium volume rose about 16% in 1984, losses went up by 26%. The after-dividend combined loss ratio amounted to 164%. Clearly, malpractice has once again become an unattractive line of business in the insurance market. Best-case-scenario forecasts call for continued operating losses over the next 3 to 4 years and possibly longer. Thus, the crisis for hospitals and their physicians will continue, and serious efforts must be made to deal with the situation.

A number of converging factors evidence this new medical malpractice crisis. Those factors include a manifold increase in both the frequency and severity of malpractice claims against hospitals and physicians; increasing uncertainty about the law leading to higher insurance costs and problems for insurers, physicians and hospitals; greater budgeting uncertainties; pressure for inadvisable defensive treatment measures; and other related matters faced by hospitals.

In response, the AHA Board of Trustees, in February of 1985, requested certain actions be taken by AHA staff. First, the Board authorized the expansion of our own subsidiary insurance company, HPIC, to provide greater reinsurance capacity for hospitals. Next, the Board requested that loss prevention programs be promoted. And finally, the Board requested that an examination be made of the potential for improving the legal climate through tort reform. A Task Force on Medical Malpractice was convened, has met four times since last August, and will publish its final report this spring. This report will cover issues of state tort reform, pending federal legislative proposals, as well as some newer approaches to the problems associated with medical malpractice liability. The AHA will be pleased to share the conclusions of the task force with the Congress in a continuing effort to deal with the growing crisis in the area of medical malpractice.

TORT REFORM

In the area of tort reform on the state level, there are four recommendations for reform that the AHA believes could increase the availability and affordability of malpractice liability insurance. These are: a cap on non-economic damages, abolition of the collateral source rule, required structured awards or periodic payments, and abolition of the rule of joint and several liability.

Cap on Non-Economic Damages. A cap on non-economic damages is a statutorily imposed upper limit on the dollar amount of damages which a jury or judge can award a plaintiff for damages of a non-economic nature. "Non-economic" damages include those for pain and suffering, loss of consortium, mental anguish, punitive damages, or any others which are not deemed compensation for out-of-pocket loss by the plaintiff. A recent study indicates that the non-economic (pain and suffering) damages component in a sample of medical malpractice cases is extravagantly high. When pain and suffering recovery is more than $100,000, less than 2% of all cases account for more than 40% of total malpractice recoveries. Further, when compared with awards in other tort cases, awards in malpractice cases include a disproportionate share of all pain and suffering payments. Although malpractice cases account for only 3 percent of all tort verdicts for plaintiff, the malpractice plaintiff takes 29 percent of all payments for pain and suffering. Clearly, the non-economic part of these recoveries is where the most significant savings in liability and in insurance premiums can be realized.

If a statutory limit on recovery is considered, it should also provide that the limit applies to the plaintiff's entire recovery (whether the action is stated as one cause or several) and to each defendant's liability individually. Similarly, the legislation should state that multiple heirs in a wrongful death action are subject collectively to the same limitation. To hold each of multiple defendants liable to the amount of the limit, or to make defendants satisfy the cap more than once, would defeat its purpose. Finally, a broad definition of "tort" should anticipate the question of whether the limit applies to both intentional torts and those based on negligence.

Abolition of the Collateral Source Rule. The traditional collateral source rule in effect prevents a set off, against the plaintiff's award, of other amounts to which the plaintiff may be entitled for the same injury, such as medical or disability insurance. The policy argument for the rule is that a defendant should not escape the full consequences of his negligent act just because the plaintiff may reap a windfall. The effect of this rule, however, is that plaintiffs often secure multiple and unreasonably large compensation for injuries.

Reform to abolish the collateral source rule may take several different forms. Evidence of payment from collateral sources is admissible and, depending on the jurisdiction, is either considered by the jury in its determination of damages or directly reduces the amount of damages by the amount of the benefits. (If the latter method is used, plaintiff is usually given credit for any premiums' plaintiff paid to obtain the benefits.) Requiring an offset of benefits from collateral sources against damages best ensures that the provision will have its intended effect. To avoid the problem of small meritorious claims not being compensated at all, this reform might be limited to cases where the amount claimed is over $10,000, or some other minimum amount.

Structured Awards/Periodic Payments. Judgments for damages and settlement awards in malpractice cases have traditionally been paid in lump sums, even when a large percentage of the award is intended to compensate the plaintiff for uncertain costs of medical expenses or lost wages anticipated to be incurred in the future. Some state statutes now allow a court to "structure" awards attributable to future losses by providing for payment, at regular intervals, of costs actually incurred or certain to be incurred. Upon the death of the injured party, payments, or some portion thereof, cease; similarly, if plaintiff's life extends beyond the time originally anticipated, some statutes provide for continued payment. This is designed to meet plaintiff's needs, and at the same time avoid windfall recoveries by plaintiffs' heirs of monies intended only to compensate for real losses.

It is difficult to estimate exactly how much a required structured settlement provision would save, but clearly it is not insignificant. Today courts are awarding lump sum recoveries sufficient to cover all reasonably possible losses based on actuarial life expectancy tables. In fact, however, the cost of an annuity or other form of structured payment designed to provide payments for expenses as they are anticipated to occur for a given plaintiff's life is far less than today's lump sum recovery.

Abolition of the Joint and Several Rule. In most states a plaintiff who has successfully sued two or more defendants may require either one of them to pay the full amount of the award. This is the rule of joint and several liability. Usually the paying defendant has a right to "contribution" from his co-defendants, but if they are insolvent or immune from suit, the right to contribution is small solace. The net effect of this traditional rule of damages is that any defendant, even one only slightly negligent, is often forced to pay the entire award.

The joint and several liability rule of damages formed an integral part of the doctrine of "contributory negligence," which completely barred a plaintiff from recovery if the jury found the plaintiff also negligent, even to a small degree. Because this doctrine of contributory negligence often led to injustice, it has been replaced in most jurisdictions by some form of the doctrine of "comparative negligence" which allows some recovery by the plaintiff even though the plaintiff, too, has been at fault. Where the doctrine of comparative negligence is applied, the court or jury apportions and quantifies responsibility for the plaintiff's injury among those parties, including plaintiff, who are found at fault. Even though the rule of joint and several liability is inconsistent with the newer doctrine of comparative negligence, most jurisdictions, even those which have adopted the doctrine of comparative negligence, have not abolished the rule of joint and several liability. Because the rule's effect is to disproportionately punish a defendant whose co-defendant is insolvent or immune from liability, this measure holds special significance for hospitals and institutional defendants which often serve as the "deep pocket" when other defendants have exhausted the limits of their policies or have entered into an individual settlement early in the litigation.

OTHER MEASURES

The AHA feels that adoption by states of provisions such as those mentioned above will cause the tort system and the health care system to operate more fairly and efficiently for everyone. We believe that their passage will begin to diminish the size and frequency of awards and, ultimately, premiums.

There are other possibilities for reform, such as modification of lengthy statutes of limitation to reduce the uncertainty and unfairness which accompanies the "long tails" created by such statutes. The "long tail" of potential liability which accompanies injuries to minors (sometimes over 20 years) creates serious difficulties in defense, both in anticipating insurance reserve needs and in fairly defending a suit upon stale evidence and lost testimony of absent or forgetful witnesses.

The AHA also supports the implementation of hospital risk management programs. The American Society of Hospital Risk Management has officially recommended programs employing criterion-based systems for identifying adverse patient occurrences which carry with them potential for hospital and medical staff liability. Strong risk management programs, and particularly ones which are based on specific identifiable criteria, facilitate early warnings of problems in patient care and enable the hospital and medical staff to intervene to reduce or eliminate the threat of patient injuries and subsequent claims.

Finally, Mr. Chairman, the crisis in liability insurance has begun to affect hospitals in a new area--directors and officers (D & O) liability insurance. Hospital governing boards are now faced with D & O policy premiums that are rising dramatically, insurers that are withdrawing from the market (making D & O coverage more difficult to obtain), and the probability of increasing frequency and higher dollar amounts of claims against them.

Directors and officers liability insurance is designed to protect directors (trustees, officers, etc.) from the financial consequences of legal claims brought against them, individually or collectively, as a result of their service to, or actions taken on behalf of, the hospital. D & O policies commonly cover the costs of legal services involved with the defense of such claims as well as financial settlements or awards.

Prior to 1984, D & O liability insurance was easily obtained by businesses and hospitals, as it was considered a relatively low risk/low cost service by the insurance industry. Premiums were sometimes kept intentionally low in order to attract other lines of insurance business from clients. This strategy worked until a combination of rising claims and falling interest rates made D & O coverage a major loser for the insurance industry.

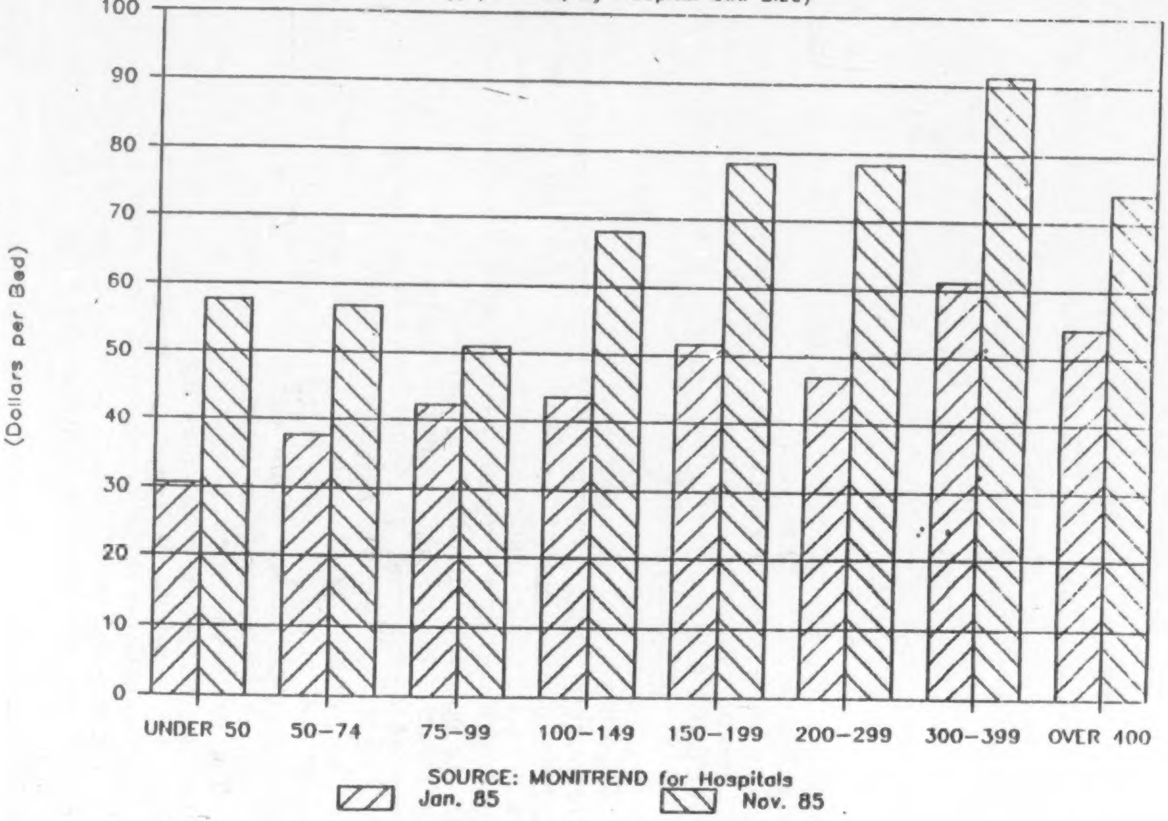
Traditionally, D & O coverage has been more of an issue for boards of business corporations than for those of hospitals. From 1980-1984, the frequency of claims against corporate directors of businesses increased 58%, and the dollar amounts of the average claim filed increased by 69%. Claims and lawsuits filed by consumers, stockholders, and others against corporate directors of businesses have alleged harm from product liability, pollution, corporate mismanagement, and other issues. As D & O claims and losses increase, insurers are withdrawing from the D & O market. This withdrawal not only reduces the supply of coverage as the demand increases due to rising claims, but also creates additional demand because the supply of coverage is diminishing. As the overall D & O insurance market capacity decreases, the D & O coverage for all accounts, including hospitals, is being squeezed.

CONCLUSION

In closing, Mr. Chairman, I applaud your efforts to examine the growing crisis in the cost and availability of liability insurance in general, and your willingness to focus on the issue of medical malpractice. The health care delivery system in this country, and particularly the Medicare program, is facing economic pressure from all sides, including the dangerously rapid escalation of medical malpractice costs. The AHA looks forward to working with the Congress in its efforts to deal with these issues.

Professional Liability Insurance

($ per Bed, By Hospital Bed Size)



SOURCE: MONITREND for Hospitals

Chairman Pickle. Thank you very much, Mr. Owen. Now we will hear from Mr. Blomquist.

STATEMENT OF CARL A. BLOMQUIST, CHIEF EXECUTIVE OFFICER, COOPERATIVE OF AMERICAN PHYSICIANS, INC.

Mr. Blomquist. Thank you very much, Mr. Chairman.

My name is Carl A. Blomquist. I am the chief executive officer of the Cooperative of American Physicians and also serve as a member of the California State Advisory Commission on Malpractice Insurance and the State Senate Commission on Cost Control in State Government.

On behalf of the cooperative, I would very much like to thank you for the opportunity to speak with you today. I would like to paraphrase my testimony.

The cooperative is a doctor-run organization providing professional liability coverage for over 2,400 California physicians and surgeons. A similar organization, the Hawaiian Association of Physicians for Indemnification~~, provides~~ professional liability coverage to approximately 350 physicians and surgeons in Hawaii.

Together we provide self-insurance services as an alternative to commercial malpractice liability insurance. Members are both insureds and insurers at the same time. The risk is unlimited financial liability for each and every member for the cost of claims against other members, and each is protected against the claims by the resources of all other members.

Cooperatives do not maintain reserves against future claims as insurance companies do. Members are assessed as required to raise the additional funds to pay existing claims.

The availability of insurance, reinsurace, and self-insurance alternatives at a reasonable cost is of paramount importance to the American public and should constitute a legislative priority for the Congress this session, for the following reasons.

The preservation of alternative methods of insuring or self-insuring against professional liability claims promotes quality health care. Cooperatives such as ours have unlimited liability for the cost of claims against their membership. The availability of reinsurance at a reasonable cost places a ceiling on the extent of this liability. Reinsurance is therefore important to the growth of those organizations.

Membership in physician cooperatives improves health care. Since the cooperative members have unlimited exposure for the acts of other members, there is a strong emphasis on improvement of professional practice standards. Approximately 7 percent of California physicians and 25 percent of those in Hawaii are cooperative members.

We sincerely recommend that Congress encourage the continued growth and viability of doctor-run self-insurance cooperatives as a creative alternative to traditional commercial liability insurance.

Physicians across the country have faced substantial increases in medical malpractice insurance rates. In certain specialties such as obstetrics, physicians have decided to limit their practices or even retire rather than pay the increased cost of insurance.

An increasing number of health care professionals will practice without liability protection if insurance or reinsurance is not available at a reasonable cost. Taxpayers will bear the cost if private enterprise cannot provide insurance at a reasonable cost to those who may be sued for personal injuries. If, on the other hand, affordable insurance or self-insurance alternatives remain available to health care professionals, the need to join peripherally-related defendants in law suits will be reduced and the exposure of taxpayers becomes limited.

What can Congress do? We support H.R. 3761 introduced by Representatives Matsui and Heftel and supported, I understand, by our Congressman from California, Mr. Thomas. This bill encourages the formation and development of physician-owned self-insurance cooperatives. The bill makes a member's required payment to the cooperatives' legally mandated trust fund a tax-deductible expense of medical practice when paid. Any refund upon termination of membership would be taxable income to the physician when received.

The bill has been structured in conjunction with the Treasury Department to be revenue neutral. It limits the deductions for all payments to the self-insurance cooperative to the amount which would otherwise be deductible as premium payments to a commercial insurer.

H.R. 3761 puts self-insurance cooperatives on a level playing field with commercial malpractice insurers whose premiums are currently tax deductible. In addition, the committee and Congress should consider uniform national tort reform legislation. In 1975, the California Legislature adopted the Medical Injury Compensation Reform Act, which, among other provisions, limited pain and suffering awards against physicians to $250,000.

In its consideration of these issues, Congress should evaluate the California experience and similar laws in other States. Ultimately, Federal legislation should be enacted to apply a uniform standard throughout the country.

Members of self-insurance organizations such as ours have created a responsible and successful alternative to reduce reliance on commercial lines of insurance. We require the assistance of the subcommittee to preserve and strengthen the self-insurance alternative at a reasonable cost.

Thank you.

[The prepared statement follows:]

SUMMARY OF
STATEMENT OF CARL A. BLOMQUIST
CHIEF EXECUTIVE OFFICER
COOPERATIVE OF AMERICAN PHYSICIANS, INC.
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

March 13, 1986

The Cooperative of American Physicians (CAP) supports a congressional investigation of solutions to the shortage of insurance capacity and availability.

1. The availability of insurance, reinsurance and self-insurance programs at a reasonable cost is essential to:

- a. Preserve alternative methods of insuring or self-insuring against professional liability claims;
- b. Preserve the delivery of health care by physicians and surgeons in private practice; and
- c. Avoid the burden on taxpayers caused when liability claims are shifted to government entities which are joined as "deep pocket" defendants in personal injury suits.

2. This Subcommittee can take the following steps to promote availability:

- a. Enact H.R. 3761 introduced by Reps. Matsui (D-CA) and Cecil Heftel (D-HI) to encourage the formation and development of physician-owned self-insurance cooperatives;
- b. Create parity in tax treatment between self-insurers and commercial insurers; and
- c. Enact national tort reform legislation to reduce and/or create predictability in damage awards and contingent fees, in medical malpractice cases.

STATEMENT OF CARL A. BLOMQUIST
CHIEF EXECUTIVE OFFICER
COOPERATIVE OF AMERICAN PHYSICIANS, INC.
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

March 13, 1986

Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Carl Blomquist. I am the Chief Executive Officer of the Cooperative of American Physicians (CAP) and I also serve as a member of the California Senate Advisory Commission on Malpractice Insurance. On behalf of the Cooperative, I very much appreciate the opportunity to speak with you today.

CAP is a doctor-run cooperative providing professional liability coverage to over 2,400 California physicians and surgeons. A similar organization, the Hawaiian Association of Physicians for Indemnity (HAPI), provides professional liability coverage to approximately 350 physicians and surgeons in Hawaii. CAP and HAPI provide self-insurance services as an alternative to commercial malpractice liability insurance. Members are both insureds and insurers at the same time. They risk unlimited financial liability for the cost of claims against other members and each is protected against claims by the resources of all other members. Cooperatives do not maintain "reserves" against future claims as insurance companies do. Members are assessed as required to raise additional funds to pay existing claims.

The availability of insurance, reinsurance and self-insurance alternatives at a reasonable cost is of paramount importance to the American public and should constitute a legislative priority for the Congress this session for the following reasons:

1. The preservation of alternative methods of insuring or self-insuring against professional liability claims promotes quality health care.

a. Availability of reinsurance strengthens self-insurance cooperatives. Cooperatives such as CAP or HAPI have unlimited liability for the cost of claims against their membership. The availability of reinsurance at a reasonable cost places a ceiling on the extent of this liability. Reinsurance is, therefore, important to the growth of those organizations. CAP pays a substantial sum to reinsure against verdicts which exceed $1.5 million. Unfortunately, reinsurance premiums are increasing and the amount of coverage, even at higher costs, is shrinking. As a result, the attractiveness of the self-insurance cooperative alternative may be diminished.

b. Cooperatives improve practice standards. Membership in physician cooperatives improves health care. Since cooperative members have unlimited exposure for the acts of other members, there is a strong emphasis on the improvement of professional practice standards. Loss prevention and peer review programs are frequently utilized when adverse claim experiences indicate problems in a member's practice. CAP's Peer Review Committee may intervene and recommend changes in practice procedure as a condition of the physician's continued membership. This self-regulation improves the quality of professional practice in ways unknown to commercial insurers.

Approximately 7% of California's physicians and 25% of those in Hawaii are cooperative members. The heightened awareness of practice habits which may increase liability exposure makes a significant contribution to improving the quality of health care. The Congress should encourage the continued growth and viability of doctor-run self-insurance cooperatives as a creative alternative to traditional commercial liability insurance.

2. The preservation of physicians in private practice is important to quality health care. Physicians across the country have faced substantial increases in medical malpractice insurance rates. In certain specialties, such as obstetrics, physicians have decided to limit their practices or even retire rather than pay the increased costs of insurance. The provision of insurance at affordable rates is essential if we are to maintain the quality of health care, to ensure that specialists are available in sufficient number throughout the country, and to preserve the private practice of medicine as an alternative to large corporate practices which provide liability protection as part of the services provided to a physician.

3. Liability should not be shifted to "deep pocket" defendants such as state or federal government.

a. Physicians will be uninsured or underinsured. An increasing number of health care professionals will practice without adequate liability protection if insurance or reinsurance is not available at a reasonable cost. When persons primarily responsible for personal injury claims have inadequate insurance coverage, lawyers routinely add "deep pocket" defendants to lawsuits, such as state-run hospitals or health planning authorities. In California, the inequity of this system has prompted an initiative on the June 1986 ballot to limit the liability of defendants to their respective percentages of fault.

b. Affordable insurance diminishes potential taxpayer liability. Taxpayers will bear the cost if private enterprise cannot provide insurance at a reasonable cost to those who may be sued for personal injuries. If, on the other hand, affordable insurance or self-insurance alternatives remain available to health care professionals, the need to join peripherally related defendants in law suits will be reduced and the exposure of taxpayers limited.

4. What can Congress Do?

a. Enact H.R. 3761 to encourage self-insurance cooperatives. CAP and HAPI support H.R. 3761 introduced by Reps. Robert Matsui (D-CA) and Cecil Heftel (D-HI) which encourages the formation and development of physician-owned self-insurance cooperatives. The bill makes a member's required payment to a cooperative's legally-mandated trust fund a tax deductible expense of medical practice when paid, within certain limitations. Any refund upon termination of membership would be taxable income to the physician when received. The bill has been structured in conjunction with the Treasury Department to be revenue neutral. It limits the deduction for all payments to a self-insurance cooperative to the amount which would otherwise be deductible as premium payments to a commercial insurer.

b. Create parity in treatment between self insurers and commercial insurers. H.R. 3761 puts self-insurance cooperatives on a level playing field with commercial malpractice insurers whose premiums are currently tax deductible. If the bill encourages the use of physician cooperatives, insurance capacity will be increased and create a significant positive influence on the quality of health care.

c. Enact national tort reform legislation. In addition, the Ways and Means Committee and the Congress should consider uniform national tort reform legislation. In 1975, the California Legislature adopted the Medical Injury Compensation Reform Act (MICRA). MICRA limits pain and suffering awards against physicians to $250,000. It limits attorneys' contingent fees to a designated sliding scale. In order to avoid double recovery, it assures that juries can hear evidence of payments made to an injured party by collateral sources. This legislation has successfully limited runaway jury verdicts in California malpractice cases. In its consideration of these issues, Congress should evaluate the California experience and similar laws in other states. Ultimately, federal legislation should be enacted to apply a uniform standard throughout the country.

d. Subcommittee assistance required. Members of self-insurance organizations such as CAP and HAPI have created a responsible and successful alternative to reduce reliance on commercial lines of insurance. We require the assistance of this Subcommittee to preserve and strengthen the self-insurance alternative at a reasonable cost.

Chairman PICKLE. We thank you, and I pay my special thanks to this panel again for your patience.

Let me talk to both of the physicians first, and Mr. Blomquist, you too.

Has the number of malpractice suits increased in the last year or two or three?

Dr. SELDIN. Absolutely, sir.

Dr. DAVIS. Yes, sir, it has tripled in the last 10 years, and the second part of the problem is the size of jury awards has gone up markedly.

Chairman PICKLE. How big are they in the medical field?

Dr. DAVIS. Jury awards?

Chairman PICKLE. Yes.

Dr. DAVIS. Into the millions of dollars.

Chairman PICKLE. On an individual case basis?

Dr. DAVIS. Yes, sir.

Chairman PICKLE. And if I understood you a minute ago, your insurance now has gone from 6 or 7 years ago from $150——

Dr. SELDIN. The oral surgeons.

Chairman PICKLE. From $150 a year to, did you say, to $66,000?

Dr. SELDIN. Yes, $66,000.

Chairman PICKLE. Is that the average physician?

Dr. SELDIN. No; that is the oral surgeons.

Chairman PICKLE. Oral surgeons.

Now, what would it be, Dr. Davis, for medical surgeons?

Dr. DAVIS. In 1984, the average verdict was $338,000.

Chairman PICKLE. Now, that means that when the physician has to pay $338,000 or $66,000, that is passed on to the consumers, to the patients.

Dr. DAVIS. Every penny of it, yes, sir. It has to be.

Chairman PICKLE. So when I go in to see a dentist and I would normally get a charge of $50, I will get charged $100 just for the insurance.

Dr. SELDIN. Mr. Chairman, I don't want to be misleading. The $66,000 definitely would be passed on in the oral surgical area. The gross average premium for the dentist in general around this country is not exorbitant. It is more in the area of $3,000 to $4,000 a year. We will not see the consumer paying the price for that at this point.

Chairman **Pickle**. I see. So you have reference only to the surgeons, but in that area, it is that high.

Dr. **Seldin**. That is correct, sir.

Chairman **Pickle**. Can any physician get malpractice insurance? Can you get insurance in any instance you want today?

Dr. **Davis**. No, sir. It has been pointed out previously that in medicine, in 1975, there was a crisis of availability. In 1985, there became a crisis of affordability. In 1986, there is both an affordability and availability crisis. As I pointed out, obstetricians, emergency room physicians, and many others are cutting back on their services.

Chairman **Pickle**. Even though the premium would cost him "an arm and a leg"—that may not be a good way to put it. [Laughter.]

Even though it would cost you an arm and a leg and you would be willing to pay it, in many instances it is not available.

Dr. **Davis**. That is exactly right, yes, sir. But let me elaborate on your point that whatever the total cost of medical professional liability is, it is borne by the public. The physician's premium, the fees paid to plaintiffs' lawyers, the fees paid to defense lawyers, the cost of investigating a case, all of that together is passed on to the consuming ill.

Chairman **Pickle**. One of the witnesses earlier this morning testified that many of the malpractice suits that are brought, approximately 70 percent of the cases, do not have merit. Of course, that is a judgmental statement on the part of the witness, but in many instances, these cases are not proven to have merit.

Dr. **Davis**. May I elaborate on that, sir?

Chairman **Pickle**. Yes, sir.

Dr. **Davis**. The national figure is 70 percent, and in our company in North Carolina where we monitor this very carefully, 84 percent of our claims require no payout at all, and yet the cost of defending those nonmeritorious claims consumes half of our defense bill.

Chairman **Pickle**. What is causing that? Is it the high jury awards? Is it high premiums? Where is the fault?

Dr. **Davis**. For nonmeritorious claims? I think, as you have heard all day, it is the public perception that this is an easy place to make some money. We think that there are some lawyers who do not use proper discretion in filing nonmeritorious claims, with the idea that if it fails, no one has suffered.

That is fallacious. The public has suffered on every nonmeritorious claim that is filed because they are having to pay the cost of investigating and defending that claim.

Chairman **Pickle**. Are the high cost of these premiums due to the high jury awards, or are there other factors?

Mr. **Blomquist**. In our company's case, it is due to all of the above. Lawsuits increased last year. New claims opened were up 20 percent over the previous year, which were an increase over the previous year as well. The amount of awards increased. The cost of settlements underlying those have increased. And the laws underlying our system have been continually liberalized in the plaintiff's favor, not by the legislature, but by the courts themselves who have come up with a number of new theories under which negligence can be found.

In our case, ours is similar to the Carolina experience. Seventy seven percent of our cases do not ever go to trial. They are dropped short of the courthouse steps. Of the ones going to trial, we prevail in about 80 percent of the cases.

Chairman **Pickle**. Well, is your California insurance commission regulating the insurance business properly there? Is it the fault of the insurance companies or is it just the system in general?

Mr. **Blomquist**. I think it's more of a system problem. We are not regulated by the Department of Insurance, but rather by the Department of Corporations in California. But it seems to be more of a system problem, a societal problem.

Lawyers today in California, where we have a lawyer glut, have a better chance of hitting it big by filing a malpractice lawsuit than they do by buying a ticket on the State lottery, by far, and the cost is much, much less. For the cost of about 40 $1 lottery tickets they can file a lawsuit.

Mr. **Owen**. May I add just one other thing, too, Congressman Pickle, and that is that the cost of reinsurance has also gone up considerably, in addition to what's already been said. And as that reinsurance goes up, it requires a premium increase at the other end.

Chairman **Pickle**. All right. Congressman Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman.

Gentlemen, I'm going to paraphrase a conversation which I heard either on television or in person many times, and I'd like your reaction to it, and it goes something like this:

The cost of liability insurance for doctors is so high that they can't afford to take it out and pay it. And the rejoinder is, well, if we didn't have so many incompetent doctors going around butchering people, we wouldn't have the problem.

Just give me your response to that statement.

Dr. **Davis**. It is clearly documented that good doctors get sued much more often than bad doctors. So that statement that you do hear on every side is totally fallacious. Even if you wanted to find a good doctor, one who has extensive training and is certified by his specialty board in his particular specialty, as opposed to those who are not, then those who are board-certified get sued much more often than the bad doctor.

We worry about the bad doctor, we want to get him out of the profession. They taint all of us in the profession. But this crisis is caused a whole lot more by suits against those who are the most highly skilled, most highly trained, those who are delivering up-to-the-minute technological advances in medicine, trying to extend this patient's life, trying to enhance the value of that life. This is a doctor who is much more apt to be sued.

Mr. **Schulze**. Why is that? Because he's working on the borderline of technology?

Dr. **Davis**. He's doing the much more difficult case, and consequently he can expect not to have totally perfect results all the time, as no doctors can. But the more sophisticated, the more complex the operation, if you are in the field of surgery, then the greater the chance of some complication developing, which most times does not in any way relate to negligence. He is held to blame for any complication that develops.

Mr. SCHULZE. Is this also where the statement comes from that most of the claims are against a relatively few doctors?

Dr. DAVIS. Yes, I think that is true.

Mr. SCHULZE. So that what you are saying is that the——

Dr. DAVIS. Well, you've heard today that in Dade County—there are pockets in Dade County, FL, where, every third doctor can be expected to be sued. You've heard 1 out of 6 earlier, it depends on what area of the country you are in.

Mr. SCHULZE. What would you do about this problem? The message I am getting, Doctor, is that it's really the good competent surgeon, let's say, who is being sued. How would you try to cure this?

Dr. DAVIS. The only cure, as I see it, sir, is to change the system. Your committee argued a great deal this morning about whether it is the insurer or the reinsurer that's at fault. Both are suffering from a nonworkable tort system that just will not work. It's got to be changed. The American Medical Association recognizes that most of these changes have to come at the State level: State legislatures, insurance commissioners. But we think the time has come for there to be Federal incentives to change these.

As Mr. Owen outlined for you, incentives to States to pass proper tort changes.

Mr. SCHULZE. The trial lawyers say we can fill the room with people in wheelchairs and so forth who have been mistreated, and what you are going to do is preclude some of these people from being compensated. What is the response to that?

Dr. DAVIS. No, sir; we are very much in favor of everybody that's injured in the health care system being compensated and being compensated reasonably. The public expectation is of a perfect result from medical science, which is and always will be an inexact science, no matter how technologically good we get; it will be a judgmental science, and there will be mistakes made.

So those people who are injured because of mistakes should be compensated. Those who simply don't get the perfect result that they have been led to expect, we feel should not be compensated.

Mr. SCHULZE. Thank you, Doctor.

Anybody else have anything?

Dr. SELDIN. Yes. I might point out a study that we did in New York a number of years ago. In response to your question, sir; we found that about 85 percent of the cases that we did have, the claims and malpractice against dentists, were against first-time offenders. We were looking for a pattern of repeatability, and we found that it wasn't happening. So I don't think, at least in dentistry, that we see these bad dentists who are continually being repeatedly claimed against, but rather it's spread quite broadly.

I have a problem in the sense that as long as there is no recourse against plaintiffs and attorneys for plaintiffs who bring frivolous suits, we can't stop them cold. We must in some way try to discourage taking a shot, is the only way to put it.

Mr. SCHULZE. Thank you, gentlemen.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Anthony?

Mr. ANTHONY. Thank you, Mr. Chairman.

Dr. Davis and Dr. Seldin, I would like to come at the cost of insurance from a different perspective. Given that it's gone up radically, what would be the increase in the cost as a percentage of doing business over that same period of time?

Dr. **Seldin**. At least in dentistry, as I said before, the gross premium that we are being forced to pay for the majority of the dentists, if the average dentist is earning about $80,000 and he has to pay $5,000, you can—and it was 600 percent lower a couple of years ago, it is not going to stop him from eating his next meal. But it begins to cut into the overhead.

For the young practitioner who is in debt when he comes out of dental school and opens up an office, he is only making $20,000 a year and he's going to be asked to pay seven or eight in malpractice premium. That's very meaningful to him. Or the older practitioners winding down. It is not as significant to the man in the mainstream at this point.

The oral surgeons are put in a position today where they can hardly find a way to stay open. $66,000 a year, $35,000 a year is very significant.

Mr. **Anthony**. In your case you are talking oral surgeons where you have anesthesia involved; is that correct?

Dr. **Seldin**. Not necessarily. It is all oral surgeons. Now there are a number of them who do not do any anesthesia in or out of the office.

Mr. **Anthony**. Well, when I was in law school in 1963, I happened to do a paper on judgments against dentists, and I found that the overall judgments were extremely low, and I guess it's because of the limited nature of the area in which they're operating and the limited nature of where the injuries could actually occur.

You are not saying that you have seen a tremendous jump in those judgments, have you?

Dr. **Seldin**. Oh, absolutely. We have seen the same thing the physicians have seen. We have seen an enormous jump in the number of cases.

Mr. **Anthony**. You don't have the million-dollar judgments that the OB-GYN would have, do you?

Dr. **Seldin**. No, sir, not with frequency. We have had them in the past year.

Mr. **Anthony**. Well, if you got a million-dollar judgment of somebody getting hurt around the mouth, they must have put the whole damn chair in there.

Dr. **Seldin**. Understand that we are just working in one specialized area of the body. We do anesthesia procedure.

Mr. **Anthony**. Well, if you could provide me with any cost, as a percentage of doing business, because it's another way to look at it.

Dr. **Seldin**. Yes, sir.

Mr. **Anthony**. I understand that the bulk number, the gross number, has gone up, but I'd like to see what it is as a percentage of doing business.

Same with you, Dr. Davis. I understand that it's gone up enormously, but I also know that the revenues of doctors from 1975 to 1986 have also gone up. I'm just curious as to what it is as a percentage of doing business. That's the way we look at it in other industries.

[The information follows:]

REQUESTS FOR ADDITIONAL INFORMATION

1. Mr. Anthony's request for information about increased liability insurance costs of the dental profession as a percentage of doing business.

The preliminary results of the 1985 Survey of Dental Practice indicate that a general practitioner dentist has an average net income of approximately $65,000 based on 60 percent overhead cost determination. At present, annual liability premiums are averaging $3,400 for the general dentist, and $23,800 for dentists who administer anesthesia in their offices. As Dr. Seldin mentioned in his testimony, liability premiums can go as high as $66,000 for oral surgeons in New York City or even $94,000 for one dentist in Dade County, Florida.

Using these figures, liability costs for the average dentist as a percentage of the cost of doing business are still relatively low—approximately 5.4 percent. However, as one does a similar analysis for dentists utilizing anesthesia, or young dentists starting out or older dentists near retirement, the impact can be much greater. Most important, there is an alarming trend towards sharply increasing liability costs which may cause the percentage of liability costs as a factor of the cost of doing business to be greater in figure.

2. Mr. Anthony's inquiry about evidence relating to judgments and/or settlements that have exceeded $1 million.

While awards of this magnitude are extremely uncommon in dental liability incidences, there are some usually connected with improper administering of anesthesia in an outpatient setting. Information has been requested on the number of dental liability cases where the settlements or awards exceeded $1 million or more from our professional liability insurance carrier, CNA. As soon as we receive such information, we will forward it to the Committee.

3. Mr. McGrath's inquiry about the impact of such liability reforms and the Canadian experience.

It is extremely difficult to estimate the proposed impact of tort reforms on the costs of dental liability insurance until such legislation has been implemented. The American Medical Association has estimated that tort reforms could reduce malpractice costs by 28 percent, and I am sure a substantial amount of analysis went into that determination.

While the American Dental Association has no precise percentage of savings that could result from enactment of such reforms, the following facts are indisputable. The most beneficial reforms would be those which minimize litigation, such as screening panels.

We base this assertion on the fact that approximately 40 percent of the allegations reported under the ADA Program are dismissed without any settlement. If screening panels would reduce the number of cases filed and/or litigated, we would certainly expect some substantial savings in legal costs and claims handling.

The proposed limit on non-economic damages set at $250,000 would have only a marginal impact on the dental profession since the limit exceeds by far the damages of all but a small minority of claims against dentists. Likewise any proposed limits on contingency fees for attorneys and structured payments for dental liability awards would be of minimal impact. However, both of these reforms should be of eminent savings to the health care system as a whole.

Other proposed liability reforms such as elimination of the collateral source rule, joint and several liability reform, a return to a "fault" standard, and most important, enhanced peer review and disciplinary activities of the professions should result in cost savings, although it would be difficult to measure in any precise fashion.

At the hearings, the Committee heard testimony that tort reforms adopted in Canada resulted in no savings in liability insurance premiums. This statement was made with the inference that such reforms make no difference on costs.

Based on conversations with representatives of the Canadian Bar Association and Canadian Dentists Insurance Program, we have ascertained that Canada has adopted a cap on non-economic damages set at $100,000, as well as other reforms such as structured payments. It is our understanding that these reforms have resulted in some cost savings, although no formal study has been done. We do know that liability insurance premium rates quoted by the Canadian Dental Association are $440 or 13 percent lower than average rates under the ADA program.

American
Dental
Association

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ADA

March 26, 1986

Dr Bruce E Cunningham
Jacksonville Med Ctr
210 Henry Rd
Jacksonville, AL 36265

Dear Doctor Cunningham:

As you are aware, professional liability has become a significant problem not only for members of the Association, but also for our patients, indeed for society itself. During the past year many of you have asked me what the Association is doing to help us with the liability crisis that is now confronting us.

I want to assure you that the Association is actively working on the liability problem for you. Attached is a synopsis of the numerous Association initiatives undertaken in response to this burgeoning crisis.

The Association is responding to this complex problem at various levels, and in many forums. However, most important, we need your help at the state and local levels. We must remember that in professional liability, as in dentistry, prevention is the key. Risk management, loss prevention, and peer review must remain the mainstays of dental practice.

As we all know, it is never easy to review the possible misconduct of a colleague. However, today it is essential if the dental profession is to reduce liability costs, maintain the quality of care and retain the public's confidence.

Today, I personally urge you to re-dedicate yourself to working with the members of your dental society to maintain the high quality of dental care by supporting and participating in risk management and peer review activities, and by strengthening the disciplinary functions of your state licensing boards.

Please join the efforts of the Association in meeting the challenges of the liability problem. We, all of us together, are the American Dental Association. Your input and support is needed if we are to resolve this liability crisis for both the dental profession and the public it serves. As always, I would appreciate your thoughts and comments.

Sincerely,

Abraham Kobren

Abraham Kobren, M.S.,D.D.S.
President

AK:lmh

ASSOCIATION RESPONSES TO LIABILITY ISSUES

The Board of Trustees has established a comprehensive program to address the four principal aspects of the current problems. A Task Force on Professional Liability Issues coordinates Association efforts in these areas.

Insurance

The Council on Insurance has been involved in ongoing consultations with the CNA Insurance Companies, underwriter of the Professional Protector Plan, to assure the reasonableness of premium rates and coverages. The Council is also working with the carrier on the establishment of professional assessment committees and loss prevention programs.

The Association has developed a standby shelf insurance company so if market conditions dictate, we will have the capability to provide our members with liability coverage through this new company.

Loss Prevention

The Council on Insurance and Division of Communications have launched an extensive series of risk management programs, including loss prevention seminars, videotapes, publications and other activities.

The Council on Dental Care Programs assists constituent and component societies with their peer review programs, while the Council on Bylaws and Judicial Affairs and the Council on Dental Practice assist in the areas of professional ethics and impairment, respectively.

The Association has adopted policy pertaining to the training and credentialing of dentists who choose to administer general anesthesia and conscious sedation. Implementation of the policy is now underway.

Three councils of the Association have instituted programs to achieve acceptance of the uniform tooth numbering and radiograph mounting system by dental schools, dentists and third-party payers.

Dental schools are also being encouraged to include risk management as part of their curricula.

Legislation

The Association is actively supporting tort reform measures pending in Congress, including S.1804, Hatch (R-UT) and H.R. 3865, Lent (R-NY). The Association, represented by Dr. Leslie W. Seldin, testified before the House Ways and Means Committee on the causes of and potential solutions to the liability problem. Dr. Seldin reiterated the dental profession's commitment to strengthen peer review, disciplinary functions, and risk management activities as a means to maintain the high quality of dental care and to reduce liability concerns.

The Association is assisting constituent and component societies with efforts for tort reform and strengthening peer review. The Association's Department of State Government Affairs has provided assistance in analyzing proposed reforms, drafting legislation, preparing testimony, and sharing information from other states.

The Association filed a friend-of-the-court brief in the Illinois Supreme Court urging that a recently enacted liability reform statute be upheld and implemented. The outcome will have implications, as legal precedent, for many other states.

The Association has joined the American Tort Reform Association, which coordinates the activities of more than 200 organizations in seeking long-term solutions to our liability problems.

The Association also participates in the Health Policy Agenda for the American People. Initiated by the AMA, the program has representation from the major health professions and industry groups, and is addressing a number of significant issues, including liability.

Education and Communications

The Association continues to publish articles in the *ADA News* and *The Journal of the American Dental Association* to educate the profession and the public on liability issues and loss prevention. The Division of Communications provides information to the public media through news releases and responses to inquiries.

The Council on Journalism distributes monthly Dental Editors Kits which provide materials for constituent and component journals and newsletters. Included are issue papers, feature articles, and periodic loss prevention columns and news releases.

Dr. DAVIS. May I give you one figure, and it's highly variable. In 1984, the average obstetrician paid $18,800 or over 16 percent of his pretax income.

Mr. ANTHONY. Sixteen percent?

Dr. DAVIS. Sixteen percent. But, Mr. Anthony, let me point out that, whatever the figure is, I don't think it's significant because if he cannot get established. As Dr. Seldin says, it may keep people from going into certain specialities because they can't get startup funds, equipment, offices and such, and early payment of that amount.

After that, all of it is passed on to society, and this is our message to you and to the American people: that doctors and dentists don't end up paying this, the American public pays for it. It's our responsibility and the responsibility of Congress to try to reduce the amount of money that the American public pays for this.

Mr. ANTHONY. I understand that. I sympathize with you. You have got my total support to try to figure out the problem. But let me say this——

Dr. DAVIS. Sympathize with the people, sir. I pass it through like every other doctor. I'm not worthy of your sympathy. It's the American people.

Mr. ANTHONY. I would like to congratulate the two associations here, anyway. At least you have had legislation introduced on what needs to be done that will at least get the ball rolling.

But listening to the figures you laid out a while ago, and then you made a statement that the tort system won't work—it appears to me that you have made an excellent argument, Mr. Blomquist and Dr. Davis, that the tort system does work.

In North Carolina you are saying that 84 percent of your cases, you have no payout. That's 84 percent of the lawyers who did not get a contingency fee, yet expended some money out of their own pocket. So that was a loss to them. The only lawyer that got paid were the defense lawyers, and that's 50 percent of your total cost, if I understood your testimony right. So under the contingency fee basis, the client puts up no money, it's the lawyer that pays the filing fee, the deposition fee, the interrogatory fees, looking for the expert witnesses to come in. And you say that there was 84 percent no payout. Well, that's 84 percent of the lawyers that ended up losing money because they didn't get any judgment back. Mr. Blomquist said that 77 percent of his cases are settled. In his case, this is physician-owned, and so you are not worried about some independent insurance company that you've got no control over their lawyers as to whether or not they are going to settle in or out of court. You have made your own independent decision that there was fault, there was proximate cause and there was damage, and you have settled 77 percent of them.

Then you say that you win 80 percent that go to court. I mean to me that is saying that the system is working with the exception of these very highly unusual cases where we do have some extreme judgments and extreme imbalances.

I'd be happy to hear you respond if you want to.

Dr. DAVIS. Yes; I think you are bringing contingency fees into this inadvertently or advertently, one. We, the American Medical Association, are not opposed to contingency fees. But it is a matter of record that the injured party gets today about 30 cents of the premium dollar. What we would like to see is a scale whereby the lawyer is compensated fairly on a contingency fee basis, but this be scaled down as the size of the award goes up, simply so the injured party gets a more equitable part of the award that the jury and the judge think they are giving him. We are not against contingency fees, sir.

Mr. ANTHONY. Do you have any evidence that you could submit for the record as to judgments and/or settlements that have exceeded $1 million in your own experience, with your own insurance company?

Dr. DAVIS. Yes; I can get it for you.

Mr. ANTHONY. If any of your associations have any total documentation as to number of judgments that have exceeded a million dollars——

Mr. OWEN. Over a million in hospitals, there are quite a few. There are some $5 million cases.

Dr. DAVIS. You heard the figure this morning of over 400 in excess of $1 million in 1984.

Mr. ANTHONY. I understand that but 400 doesn't seem like a great number when you are talking about the millions of people that we have and the thousands of people that we have practicing and the thousands of hospitals that we have.

I must admit after hearing the rhetoric and watching some of the talk shows and watching the chamber of commerce go at the trial lawyers, that I would assume the number was way up there. When I found out it was only 400, it made me start more seriously examining exactly where the empirical data is. We had another panel earlier that got into that.

Any help that you could give us in trying to analyze exactly where the tort system is failing and breaking down would be helpful.

Mr. OWEN. Sometimes these awards are in special places. Missouri, for instance, had a number of large awards and it created a very difficult problem for coverage of the Missouri hospitals. The company up in St. Paul, North Star, has now run into trouble and they are trying to find some place to cover up there. You see, you might get three or four awards in a State because something happens or the jury all of a sudden—one jury looks at another jury and you get a big chunk there.

If you look across the country, for instance, in New Jersey, in a company that I am most familiar with, we have had only two awards in 10 years that have been over $1 million. In New York City, right across the river, there are all kinds of awards over $1 million. It is disproportionate as you look at the country as a whole.

Mr. ANTHONY. Just one final question. Mr. Blomquist, I will let you respond.

If the Congress would go along with these two pieces of legislation that you have talked about or if we decided to go into tort reform, would you anticipate that you would get something in return for that, that is, would premiums go down? Would there be other lines of insurance that would be offered that are not being offered now?

Dr. **Davis**. I think two things would happen. I think the rates would stabilize and there would be more competition. There would be more companies staying in it. That's my personal opinion.

Mr. **Anthony**. Mr. Blomquist, you indicated a minute ago you may want to make a comment.

Mr. **Blomquist**. In our case, to the extent that the cost went down, there would be an immediate decrease because we only charge the doctors in a given year, at the beginning of the year, for what we anticipate paying out in that year, not 5 years later or 7 years later.

Your calculations are roughly correct. About 5 percent of the cases do go to court to an adverse judgment. That 5 percent drives the huge settlement engine in most cases where indemnity is paid is a result of settlements. We have a mandate by the State government to investigate promptly and where we find a case of liability to pay a fair amount. We find ourselves going to court only where we differ on liability.

Last week we went to court where a panel of our physicians reviewed the case and found no liability and we decided to go to court on that case. We lost the case in excess of $1 million. There were some reductions from that in terms of our final costs. Those things do happen.

We paid out voluntarily last year in excess of $15 million for our small group of physicians.

Mr. **Anthony**. Are your physicians paying less or current commercial rates for coverage?

Mr. **Blomquist**. We are paying substantially less than the marketplace today for our physicians. They are watching each other like hawks, with unlimited personal liability, you have to.

Mr. **Anthony**. Could you say what percent is lower?

Mr. **Blomquist**. I would say our physicians paid about 45-percent less than the marketplace currently on average.

Mr. **Anthony**. In your statement you say you would like to have full insurance law protection. I guess my final question is what would you do with that additional 55 percent? What could you do better with all of those laws as an insurance company that you are not able to do right now? What could you tell the insurance companies as to how they could better run their business?

Mr. **Blomquist**. One of the key reasons for success, we have removed the insulation that an insurance company typically has, even a doctor owned insurance company. If the doctor next door catches a cold, they are going to be finding themselves sneezing. They are going to get hit hard in the pocketbook. When you have that risk, you really watch out for not only your own practice but the other fellow's practice as well. It is a system that has worked.

Mr. **Anthony**. Peer review.

Mr. **Blomquist**. We have extremely strong and effective peer pressure review. It has worked and is a strong reason why our costs are lower. The typical structure of an insurance company doesn't allow that.

Mr. **Anthony**. Thank you, Mr. Chairman.

Chairman **Pickle**. Thank you, Mr. Anthony. Mr. Guarini.

Mr. **Guarini**. Thank you, Mr. Chairman.

Gentlemen, I know there is a great problem that exists out there and it is causing a tremendous amount of tension between lawyers and doctors. Maybe part of the problem is that we have the best delivery of medicine in the world and the doctors have gotten very good at it, and we have the best delivery of legal services in the world, and maybe the lawyers have gotten to be too good at it also. Maybe this is a product of a very advanced society. Both should be congratulated.

For every doctor that gets sued for malpractice, there is another doctor that testifies against him that says that in fact he did commit a wrong. The testimony comes out of your own committee, out of your own membership, in order to establish these kind of cases.

It also seems to me you also have a lack of discipline in the medical profession. Lack of discipline in the sense that anybody can claim to be any kind of a specialist as long as they are an M.D. Lawyers get disbarred by large numbers in my State of New Jersey. I don't see doctors having their licenses taken away from them to the extent that lawyers have their licenses taken away. I know doctors, as soon as it happens, they go to another State and they open up in another State and then the problems can happen in another place.

They will hang out a shingle and say, I'm an orthopedic surgeon, not certified, hold themselves out to the public to be a person who is highly qualified in a very narrow and limited expertise of medicine and get big fees and unfortunately, there is nothing done to keep these kind of people, often people who went to foreign medical schools that weren't very good or maybe were charletons with an M.D. license and consider themselves an expert in neurology or a neurosurgeon. That is a very highly sensitive trade or profession.

I guess what I am trying to say that lawyers have to do an awful lot to clean up their act but I think the doctors have to clean up their act also. You can't put the fault just on one side. It is not one easy question. There is not one easy answer. There are probably many parts to the problem. Maybe there is tort reform, judicial administration of justice in our court system. Perhaps the insurance industry can help to clean up its act.

If everybody really made a contribution, perhaps we can get to some kind of a logical and concerted conclusion.

Mr. Owen. Congressman, for the record, I think it should be clear that although as you say, a doctor may put a shingle out and he may have an unrestricted license, in order to practice in a hospital where a highly technical neurosurgeon may practice, he has to be a member of that medical staff, the organized medical staff, and that board of trustees of that hospital is responsible to see that he is certified and the medical staff is responsible to see——

Mr. Guarini. That is if he is a member of the hospital staff. He can do anything he wants to, if he wants to put any kind of specialist under his name, just as long as he is an M.D., not in a hospital, but he can still hold himself out as being an orthopedic surgeon and put a shingle out on a side street. Maybe you should allow that. There is a lot of thinking as to what we should do in order to come to a many forked conclusion here.

You don't like to have your fees regulated. That is the biggest battle we could ever have in Congress. I guess lawyers in the democratic process don't want to have their fees regulated also. I am sure you don't want to have the FTC regulate the medical profession, but yet you want the legal profession to be regulated.

It just seems there is an inconsistency in the positions that are being taken. I know once we try to regulate medical fees, there is going to be one hell of a hue and a cry that is going to be out there because that is the biggest thing we could ever have as a problem here on Capitol Hill, to try to regulate the AMA.

What I am really saying is that I am with you in many ways. I want to see us get to the bottom of this problem.

I understand you said that the average award is $338,000 in 1984. I am just wondering from the highest cost of living index we have, it is in the medical delivery health services, hospitals, doctors, et cetera. If 10 percent is the amount that we have increased our medical cost of services in the last ten years, if it has averaged 10 percent, and I think probably some other costs have gone up more than that, after 7 years at 10 percent, compound interest being the eighth wonder of the world, you are almost doubling what the figure would be after a 7-year period. If you go with a 10-year period, you would probably go two and a half times.

When you say that the size of the awards has tripled, what you are really saying is the cost of living, as far as the health delivery services are concerned, has almost tripled in that period of time. I don't see where that is dispositive of any answer to the problem.

Could you address yourself to this? I know you have a large increased cost. I am just wondering whether or not you don't feel that the cost of medicine has really kept pace with the cost of verdicts.

Dr. DAVIS. I said that the jury awards had gone up a third in the last 2 years, and the number of claims had tripled in the last 10 years. I didn't say they had gone up 10 percent.

Mr. GUARINI. No, it says the size of the award has tripled in 10 years. This is in the statement here. Now I'm saying that I'll bet since 1975, that the cost of medicine has more than doubled and probably has tripled.

Dr. DAVIS. I don't believe so.

Mr. GUARINI. You deny that. You deny that we've had a 10 percent increase per year for the last 10 years? And if so, your figures prove nothing, because all you're saying is that we're in a high cost society today.

Dr. DAVIS. Mr. Guarini, my whole point is regardless of where these figures come from, it's the American people that are unfortunate enough to get sick that have to pay these costs, and a large percentage of them are unnecessary. Therefore, all of us—and I appreciate your conciliatory attitude about this—all of us need to work together.

Mr. GUARINI. I agree.

Dr. DAVIS. And it turns out to be the American people who pay the costs, regardless of who has the pass-through authority, the doctor or the hospital, we all need to work to cut down on these unnecessary costs.

Mr. GUARINI. I'm with you 100 percent on that, Doctor, in principle, but may I say that in Canada, I understand that joint and several liability has been removed, and there are collateral settlements, which you are advocating. Is the situation in Canada any different than it is now, even though they had those reforms in the system?

Mr. OWEN. What it's done, it has stabilized the rates somewhat. They didn't go up as fast. The crisis we are facing today, although it's partly one of high cost and we don't want to get into a debate about what went up fast and what didn't go up fast, but the real problem that I see is that one of reinsurance. With the reinsurance market moving out of the business, where does an insurance company, like a captive like New Jersey's, go to get reinsurance to cover itself? And if that reinsurance market dries up completely, then our primary companies are left, with increasingly high prices that they will have to pay for less and less coverage. Because usually what you do is you cover a portion of primary, $200,000 or $500,000, and you turn over the rest of it to a reinsurance agent or to a reinsurance company. You want to get $1 million coverage or $3 million coverage.

Let's just say that everything was going up this way, that what was worth $300,000 10 years ago is now worth $1 million. So if you needed $300,000 coverage 10 years ago, now you need $1 million coverage. If you wanted three times that, you needed $1 million coverage then, you need $3 million now.

Mr. GUARINI. But I'll bet if you bought a house 10 years ago in 1975, the value of that house would be three times what it is today. What's the difference?

Mr. OWEN. The difference is I can't get the 3 million now.

Mr. GUARINI. Well, now you're talking about availability, you're not talking about cost all of a sudden.

Mr. OWEN. No, I'm talking about both.

Mr. GUARINI. No, we were talking about cost.

Mr. OWEN. All right. If it was just cost, if we were just arguing cost, we'd still be here arguing it's too high and so forth. OK. But there is a dual problem here. One is cost and the other is availability of the reinsurance market. Lloyds of London has quit writing for most companies here in the United States. When you look to see, you see the satellite go up, you see what happened in India, you see the plane come down. It's not because of hospital medical malpractice has occurred, it's the product liabilities across the country.

Mr. GUARINI. Are there some States worse than other States, like California being far worse?

Mr. OWEN. Sure, New York.

Mr. GUARINI. Now isn't New Jersey a State that's pretty much in line?

Mr. OWEN. Pretty much in line right now.

Mr. GUARINI. So why should New Jersey suffer because California doesn't put its house in order?

Mr. OWEN. I have just as much trouble trying to get reinsurance for New Jersey companies as California or New York does. Because everybody's in the same markets.

Mr. **Guarini**. That's right, because we're in the same market. Like cost containment, New Jersey has been working very, very well. And then we would suffer because the rest of the States of the Nation, or part of it, would not have its cost containment properly lined up.

I guess what I'm trying to say is that maybe it's important for us to look at each problem thoroughly and analyze the figures, instead of just throwing out figures, and if you can, for half the price, have your own nonprofit organization and cover yourself as far as malpractice is concerned, which I understand, Mr. Blomquist, you said that the costs are down 45 percent, maybe that should be the way to go. And if it is the way to go, then you have self-insurers within the captive insurance companies, like truckers and like other industries are starting to do.

All insurance has gotten high. The panel before you, nonprofit organizations, day care centers, their insurance went up 10 times. Liability on houses has gone up four to six times. So you are not the only person that's caught in a crisis. It's an epidemic, and perhaps greed on the part of some insurance companies that we are really suffering from.

So I wouldn't put all the blame on lawyers, or maybe on the court system, because our democracy has worked pretty well, and the people do get good legal service. And if there is a wrong there, it shouldn't be capped. The person should get what they are entitled to if there is pain and suffering.

Yes, Dr. Davis.

Dr. **Davis**. What you are describing, Congressman, is where we were in 1975. Doctors said it's insurance companies as well as the lawyers, so we'll have our own nonprofit companies. We have found we are in the same problems as commercial companies, as joint underwriting ventures, patient compensation fund, whoever administers these funds, we are all in the same problem. So founding nonprofit companies has been tried. It has failed simply because the system will not allow professional liability companies or reinsurance companies to operate in this country today. We have got to have tort relief or we are not going to have coverage, and we are not going to have medical services.

Mr. **Guarini**. Well, I thought Mr. Blomquist said that your system, as far as——

Dr. **Davis**. The 35——

Mr. **Guarini**. Is it working out in California?

Mr. **Blomquist**. Our system is working relative to the cost of insurance, but our costs went up substantially last year.

Mr. **Guarini**. But you said it's still 40 percent lower than the regular private insurance company, and you're in the worst State in the Union as far as verdicts are concerned. So if you could do that kind of a job, why can't insurance companies work closer to responsible figures?

Mr. **Blomquist**. Personally my belief is that the difference in structure makes a tremendous difference. An insurance company you pay a premium, and what happens in the coming year is their responsibility, the insurance company's responsibility for the part of the person buying the insurance.

In our case we charge a fee for that year, and if it is not enough to cover the cost we are actually paying out, we come back and we get some more.

Mr. **Guarini**. But that's exactly what insurance was in the first place. Down the Yangtze River came a thousand ships every year, and three of them got lost in a storm and everybody agreed that they'd pay the loss of the other three. It is back to basic principles, and it works because that's how insurance was born in the first instance.

Dr. **Davis**. Congressman, may I suggest in California he is insuring some 2,400 doctors, and 300 in Hawaii. He is postponing the payments that his insurers are going to have to pay because he has a right to assess them in the future. He is simply putting off the bullet that his doctors are going to have to bite. In his State of California he has got three captive physician-run companies who are in the same problem as every other insurance provider. If they are paying their fees up to date and don't have assessibility hanging over them, as his members do, they are all in trouble.

Chairman **Pickle**. Thank you, Mr. Guarini.

Mr. McGrath.

Mr. **McGrath**. Thank you, Mr. Chairman.

I might point out for my colleague—since he mentioned that we would have a crisis if we limited physician fees—that we already do in terms of the freeze in Medicare and Medicaid reimbursements and also the threat of mandatory assignment. That, to me, is dictating price policies.

Let me ask this question for both doctors and dentists.

Where are the disparate awards? You mentioned the States of New York, of course, where I'm from, and California. Beyond those States, what States and in what specialties? I can understand oral surgeons, but the dentists who fill teeth and maybe do periodontal work.

You said $5,000. That doesn't sound overly obtrusive to me.

Dr. **Seldin**. It isn't yet, sir. We have found that of the States beyond New York and California, we have problems, severe problems, in Florida, Illinois, Michigan, Pennsylvania.

Mr. **McGrath**. Is this a factor of the population?

Dr. **Seldin**. I believe it revolves around the more sophisticated urban centers. When you get out into the rural areas, and we do territorialize in some of the States, so that when we get away from the urban centers, we find that the problems are much less severe.

Mr. **McGrath**. And does the $66,000 premium for oral surgeons in New York, is that the same as what occurs in Michigan?

Dr. **Seldin**. No, sir. That would be one of the more severe numbers. I think as you look down the urban areas of the country, the oral surgeons' rates more approximate $25,000 to $35,000, but they are significant.

Mr. **McGrath**. Well, we're talking about vastly disparate numbers within the same specialty and within the same profession.

Dr. **Seldin**. Absolutely. May I point out that we shouldn't center totally on the oral surgeon, because as you ask the areas, the general dentist, the periodontal problems are rampant.

Mr. **McGrath**. Do oral surgeons who don't use anesthesia get a better break than those who do?

Dr. SELDIN. No, sir.

Mr. MCGRATH. Why not?

Dr. SELDIN. Because what we've found with experience is, the oral surgeon group in general has incurred the severe loss factor, and general anesthesia alone is not the problem.

Mr. MCGRATH. Well, I'm not trying to pick on oral surgeons—why wouldn't somebody who proceeds with a less risky methodology not have a lower premium than those who do?

Dr. SELDIN. Purely the analysis of the statistics. What we do is, we rate the surgeons and those who do general anesthesia, and we have dentists in this country who are performing procedures other than oral surgery under general anesthesia.

Mr. MCGRATH. Then what you're telling me is that anesthesia is not a factor.

Dr. SELDIN. Anesthesia is a factor, sir.

Mr. MCGRATH. OK.

Dr. DAVIS. Sir, in medicine, in most States, we have eight classifications depending on the complexity of practice, meaning those family physicians who do no surgery, psychiatrists who put them on the couch and that's all, run very little risk, and they are class 1 and it goes up to class 8 with obstetricians, anesthesiologists, orthopedists and such. So we do classify them, and each class has to stand on its own.

Mr. MCGRATH. In either profession, do doctors within subspecialties organize themselves into self-insurance pools? For instance, how much liability would an internist have as opposed to a neurosurgeon? Are the internists getting together and creating their own pool and then perhaps lowering their rates by doing such?

Dr. DAVIS. In answer to your first question, the internist doing cardiology has much less exposure than any surgeon. And as for the second question, yes; they are getting together. We pool them in our own category within each State. But you're right, such societies as the American Society of Internal Medicine are bringing forth their specialty policy.

Mr. MCGRATH. And where are they getting this insurance from?

Dr. DAVIS. My understanding is that some commercial company is writing it for them.

Mr. MCGRATH. And I understand—since I have studied this problem for 12 years—I was the ranking member of the Health Committee in the New York State Legislature. I can tell you that we have used every available avenue of relief other than tort reform in New York. Improving the use of annuities for long-term payments of pain and suffering and other awards.

But frankly, unless we are able to come to some agreement as to how we're going to proceed on this, those of us who are not in either the legal profession or the medical profession are going to have to make some tough decisions.

Mr. OWEN. If I could just comment, Congressman, because I think you were asking about where the big awards are, we're finding from the hospital side that it's mostly in the neonatal area. Everyone expects to have a perfect baby. If that baby isn't perfect, then somebody is at fault.

My grandmother used to say that things were an act of God. There's no such thing as an act of God anymore. Somebody's to blame.

Mr. **McGrath**. Well, let me ask you this. Most babies are born in hospitals.

Mr. **Owen**. That's correct.

Mr. **McGrath**. And most hospitals don't deliver babies; doctors do.

Mr. **Owen**. Yes, but the hospital gets sued.

Mr. **McGrath**. Well, that's the point. Do you think hospitals should?

Mr. **Owen**. Get sued?

Mr. **McGrath**. The fact that they happen to have insurance, and the birth happens to occur in a hospital delivery room, performed by a doctor, why should the hospital be liable for that?

Mr. **Owen**. Well, that's part of why we think you ought to abolish that joint rule of whoever's got the money gets sued. They sue everybody. And then we——

Mr. **McGrath**. Well, how much risk—I mean how much blame is assessed to the hospital under those kinds of——

Mr. **Owen**. A good bit of it in many cases. It depends on whether the nurse——

Mr. **McGrath**. And what is the determination of the good bit of it? The fact that they happen to have the insurance?

Mr. **Owen**. Sometimes the hospital and the doctor are sued separately; sometimes they're sued jointly. It depends on the way the suit goes. But in most cases, both the hospital and the doctor end up paying.

Mr. **McGrath**. Well, everybody ends up paying.

We heard testimony today that tort reform is already in existence in Canada, and that the awards and the premiums are the same as we have here. Seemingly the inference is that that doesn't make any difference.

What kind of information can you supply that indicates that tort reform would make a difference?

Dr. **Davis**. Actuaries for the American Medical Association estimate that if you bring forth the tort reform and incentive legislation that is before you, that from $800 million to $1 billion will be saved in premiums alone. And as you well know, that's only part of the cost, part of the total cost picture.

We think there will be early and specific savings.

Mr. **McGrath**. Does that assume that all damages are going to be—I don't know this legislation specifically—awarded through annuity payments or lump-sum payments or how?

Dr. **Davis**. Yes. That assumes that all of our reforms that we have recommended to you, that you have heard over and over, have been enacted, including structured settlements.

Dr. **Seldin**. Mr. McGrath, in New York State this past year, there was significant tort reform passed. We hope more will be done.

We, as the dental profession, have employed actuaries to evaluate what the impact would be. Knowing it's a long-tail business, we're still guessing, as perhaps they still are in Canada, and we can only provide for you whatever these guesses will be, and we would be more than willing to do so. [See subsequent response at p. 279.]

Mr. McGrath. I don't think I have any further questions, Mr. Chairman, and I thank the panel for their testimony.

Thank you for your consideration, Mr. Chairman.

Chairman Pickle. Gentlemen, I believe that completes the questions that the members want to ask of this panel. We regret that you were the last panel.

We have concluded here, after almost 7 hours of testimony. Although the hearing was rather broad-ranging, the committee also would like to point out again that we are trying to get from the various segments of the industries affected by this problem their views and to establish as many facts as we can.

We know that the premiums are high or too high, that the tort suit awards are high or too high, that hospital costs are high or too high, and that there is a question about the quality of regulation within the States.

We are not trying to say what ought to be done and we are not working from any specific bill, but we can say this is one of the most serious problems facing American business, individuals and professions that we have today, so we are going to continue these hearings.

The next hearing will be this Monday morning at 9:30. It will be another long day of some seven panels. We hope it will be as interesting as it has been today, and I am sure that it will be helpful also.

So we thank you very much.

The committee will stand adjourned until Monday at 9:30.

[Whereupon, at 4:17 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Monday, March 17, 1986.]

COSTS AND AVAILABILITY OF LIABILITY INSURANCE

MONDAY, MARCH 17, 1986

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman Pickle. The subcommittee will please come to order.

Today we open the Subcommittee on Oversight's second day of hearings to discuss the costs and availability of liability insurance. Last Thursday, we heard from the insurance industry, State regulators and legislators, lawyers, doctors, and operators of voluntary, nonprofit groups. All agree that this country is facing a serious liability insurance crisis. No one agrees on the specific causes, the culprit, nor the solution. This is very alarming. Every segment of this country's economy can expect to be affected by the insurance crisis, if they haven't already been hit.

Our goal today is to continue our dialogue on factors contributing to the high costs and availability of liability insurance. In doing so, this subcommittee will be in a position to sort out the relevant facts and correct points of view. Hopefully, this will provide a comprehensive record on which Congress will be able to reach conclusions on what needs to be done. Clearly, this is not a simple task.

I am confident that each of the distinguished witnesses scheduled to testify today will provide us with further insight into the matter.

Today we begin with four witnesses on the first panel. But, before I recognize and identify each one of the witnesses, I want to yield to my colleague, Mr. Schulze, for any opening statement he might care to make.

Mr. Schulze. Thank you, Mr. Chairman.

Today's hearing, the second of three our subcommittee plans to hold, includes some of the most interesting witnesses ever to appear before us.

I look forward to hearing their views on why American businesses, State and local governments, and thousands of professionals cannot afford or even obtain insurance coverage.

I expect today's testimony to provide us with divergent views on the current availability crisis and perhaps we may begin to come to the conclusion that no one view is the right one.

If this is, indeed, the case, then we should start immediately to bring all sides to the table and come to an agreement on solutions to this crisis.

If not, this crisis threatens our society in ways we can not begin to imagine.

The education and health of our children may be at stake. The ability of American businesses to remain competitive with our trading partners could suffer. Things we take for granted, such as recreation and dining out, may become a thing of the past. I hope today's hearings will move us toward the proper solution.

Again, I would like to commend you, Mr. Chairman, on the fine selection of witnesses we have today, and I hope that we can proceed expeditiously.

Chairman PICKLE. Do any other members have any preliminary statements they'd like to make?

Well gentlemen, the top of the morning to you. Happy St. Patrick's Day.

This is a very unusual panel and probably a panel capable of giving us some decisive commentary about our problem as any panel we could put together.

I want to ask each one of you to summarize your statement for the committee in 5 minutes. However, we are not going to try to cut off testimony on the first witnesses.

All through the day, though, we are going to ask the witnesses to summarize their testimony in 5 minute segments and ask the members to adhere to that limitation, also.

We have seven panels today. Many of them consisting of three or four witnesses or more in a group. So, we will be going all day, probably, and we need to move along.

All of the statements will be made part of the record if you have submitted written statements to us. Unfortunately, we do not have written statements from some of the panelists, which we are hoping we will get during the day. We ask your cooperation.

Now, we are very pleased to start off. Let me first identify each one of the witnesses.

Mr. Ralph Nader is the founder and he is either the president or the director—what is your title, Mr. Nader? Do you have one?

Mr. NADER. No, I don't have one.

Chairman PICKLE. Mr. Nader, founder of the Center for Study of Responsive Law; Mr. Melvin Belli, attorney from San Francisco, CA.

Mr. BELLI. I am just a country lawyer.

Chairman PICKLE. Mr. Victor Schwartz, a prominent attorney here in Washington, DC. Would it be right to refer to you being known as "Schwartz on torts."

Mr. SCHWARTZ. That is me.

Chairman PICKLE. And Mr. Benjamin R. Civiletti, attorney in Washington, DC, and former Attorney General of the United States, representing the American Tort Reform Association.

We will start off with testimony from Mr. Nader. Mr. Nader, if you will proceed, please.

STATEMENT OF RALPH NADER, CENTER FOR STUDY OF RESPONSIVE LAW

Mr. NADER. Thank you, Mr. Chairman.

The concern that all of us have about the availability and pricing of liability insurance starts with the recognition that many people in this country do get injured.

They are exposed to diseases. These injuries and diseases are traced to either negligent perpetrators or to defendants whose products are defective and who cause the danger or whose chemicals are harmful and who cause the disease.

Responding to these injuries over the last hundred years or more, carefully crafted common law by judge and jury have gradually expanded the rights of injured people to secure redress in the courts against wrongdoers or against perpetrators of harmful products.

These common law rights represent one of the great pillars of our democracy. Whenever I go abroad and people say, what do you think of the most fundamental superiorities in the United States compared to other countries, I say, comparatively it is civil liberties, civil rights, and safety rights.

The respect for the physical integrity, the health and safety of people by our law, the common law is not as susceptible to political influence or political campaign money.

It judges dispute on the merits in open court subject to appellate review. Most judges were formerly lawyers for business. They are not known as radicals. Juries have been remarkably stable in their judgments over the years.

Now, on top of this structure comes the insurance industry underwriting risk to make money. We are now able, similarly to the ability of weather experts, to determine the preconditions for tornados. We are now able to predict when the insurance companies are going to go berserk.

There is usually a period of high insurance rates, a period of premium competition for a change or cash flow underwriting at the extreme.

To get the premiums in, to get the high interest rates, as a result of the rate of return begins to decline, even accepting the reserves and the assumptions of the industry, which some think are exaggerated, the rate of return began to decline, to hit bottom in 1984, and that is when you have to say to yourself, watch out.

That is when the insurance industry suddenly rediscovers the malpractice crisis, product liability crisis, juries, judges, courts, and begins to arbitrarily cancel, begins to arbitrarily increase premiums, 600, 700, 800 percent on businesses that have never had a claim for 30 years and begins to reduce coverage.

At the same time the rate of return starts going up. The insurance companies profits are now soaring. The stock exchange index for casualty insurance companies are soaring, double that at Dow Jones in 1985.

They have had highs every year since 1978. Their assets are up smartly, yet they are persisting not only in fleecing thousands of businesses, professional firms and nonprofit day care centers, municipalities, they are not satisfied with their abdication, for their duty of loss prevention to keep their claims down by advancing health and safety and use their political muscle for safer work places, cars, et cetera—with the exception of a few companies on air bags—they are not satisfied with fleecing and with abdicating their loss prevention duties.

Now they want to go after the basic rights of injured people in our country. The General Accounting Office has pointed out many facts about this industry. One is that State regulation is abysmally weak.

This is an industry which is exempt from the Federal antitrust laws, exempt from Federal regulation, exempt from Federal inquiry by the Federal Trade Commission which has had $75 million in profits in the last 10 years, according to the GAO without paying any Federal income tax, including negative income tax, which has the ability to create its own losses by exaggerating its reserves and writing them off on the current tax forms and which surrounds its activities with technical jargon that tends to deter inquiry.

What we need is insurance reform. There is absolutely no evidence that verdicts and settlements over the last 25 years have done anything but barely keep up with inflation and population growth.

Study after study has exploded the myth of litigation explosion and certainly when you compare it with the premium explosion, it is quite modest, indeed.

Reforms for Congress are clear. Revoke the McCarron-Ferguson Act and expose this industry like all other industries to the Federal antitrust law; create a Federal office of insurance to monitor the industry and establish standards for State regulators to follow; repeal the insurance industry exemption from Federal Trade Commission jurisdiction; expand the Risk Retention Act so as to allow businesses to self-insure, such as day care centers or trucking firms and the like.

This would override the laws in over 38 States preventing businesses and consumers, Mr. Chairman, from jointly buying group liability insurance.

You can buy group health; you can buy group life. You cannot buy group auto; you cannot buy group homeowner; and businesses cannot buy group liability.

These laws should be revoked or preempted by Federal legislation; and also to regulate Lloyd's of London and other foreign reinsurers who have a very significant role in this so-called insurance "strike 'em and gouge 'em" strategy.

I was testifying over at the Senate a few days ago, Mr. Chairman. I criticized Lloyd's of London at some length. As I was walking out of the hearing room, a representative from Aetna came up to me and said, "We are very pleased with your comments on Lloyd's of London."

I said, well, "Why don't you make them publicly? You would have great credibility, Aetna, the victim of Lloyd's of London."

And the answer, in effect, was, well, we don't say these things out of school.

I think that the fact that our country is being arm twisted by foreign reinsurers pulling billions of dollars of premiums out of this country, furthering the trade imbalance, and these foreign insurers are demanding almost like another reincarnation of King George—King Lloyd's—that our legal system be brought down to the medieval level of the British system where there is no contingency, virtually no punitive damages, very difficult to get a trial by jury, where the losers pay the winners legal fees.

Imagine trying to sue Ford and paying Ford's corporate law firm fees if they happen to lose in a pentyl fuel tank case because they can't get the kind of apparatus and experts paid for that Ford Motor Co. can.

This is what is going on here. It is not just an economic problem. It is a problem that affects the health and safety of millions of people.

If architectural engineering firms are canceled from pollution coverage they cannot do their work, and if asbestos removal firms are canceled, they cannot do their work in the schools and other buildings in the land.

So, I suggest, Mr. Chairman, that these reforms be given serious consideration by the Congress and that you try to help the States more effectively regulate this industry.

What we are seeing, in conclusion, are tens of thousands of businesses for profit and nonprofit being subjected to totally arbitrary underwriting practices in order to further a political agenda of stripping people, injured people, of their rights to redress in court.

I would like to leave, in conclusion, with your committee, a letter by a trucking firm president in Indiana who said, "I am in the trucking industry, and despite an excellent motor carrier safety record, absorbed 150-percent increase in insurance rates in 1985 renewal and have been advised to expect a 600-percent increase at renewal this year if the markets we have approached agree to quote our coverage at all."

This is why the republican insurance commissioner of New Jersey said we should not permit the industry to abuse its policyholders as it implements new strategies to address its past mismanagement practices.

I will leave the commissioners statement with you, the letter with you, and a series of articles which I have written on this situation for the printed record.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Nader. Your letter will be included in the record.

[The information follows:]

The facts are beginning to catch up with the runaway casualty insurance and their backup, foreign reinsurance firms like Lloyd's of London.

Blaming everybody but themselves, as they arbitrarily cancel policies or rocket their premiums five or ten fold while reducing coverage, these companies, soaring with profits, are hoping that their jolted victims, which include day care centers, municipalities, physicians and many small businesses, will push legislatures to restrict the rights of injured Americans to sue defendants responsible for hazardous products or conditions.

Will the insurance victims turn on the injured victims and lobby lawmakers? Or will they turn on the insurance companies and demand some answers and some reforms? A lot is at stake—tens of billions of dollars and safety rights—depending on which direction is taken.

Let's look at a few recent scenes from around the country. A few days ago at a public meeting of 700 consumers, business people and physicians in Portland, Oregon, the doctors were shocked to learn that the major medical malpractice insurance company—CNA—had made over 30% return on net worth selling Oregon doctor's policies from 1976 to 1983.

In Providence, Rhode Island, before an official commission studying the malpractice insurance roller coaster, it was learned that only eleven physicians were responsible for 24% of the entire payout of verdicts and settlements over the past ten years. There are 1700 practicing physicians in Rhode Island. Other states, including Pennsylvania and Florida, have similar situations and all states do a poor job of disciplining incompetent doctors.

In Paramus, New Jersey, Roy Cohen, who started a successful used car rental business by the name of Affordable Rental Cars, found his insurance cancelled in December. His claim record was very low. In desparation he located alternative insurance at three times the price with only 5 percent of the coverage. Now, an aroused Cohen wants to start a self-insurance company for auto dealers.

There is a spreading awareness in the business and non-profit community that the casualty insurance industry is manufacturing the crisis, refusing to disclose detailed data line by line, state by state, and using its abused policyholders as pawns in rolling back victims rights to sue and recover compensation. Already just one in twenty victims of medical malpractice receive any money for their injuries; the industry wants to make it more difficult for the one person in twenty to achieve justice in courts.

Four congressional hearings are scheduled on the liability insurance situation during February and March. Hearings are being held in dozens of state legislatures. And Commissions of Inquiry, such as established by New York's Governor Cuomo, are underway in several states.

Other groups are discovering the facts by surveying their members. The National Association for the Education of Young Children (1834 Connecticut Avenue, NW, Washington, DC 20009) examined the effects of rising insurance rates and unprecedented cancellations on over 250 child care programs in 43 states. "Payments on all claims reported by child care programs accounted for just 3 percent of premiums they paid during the past year, not taking investment income into account, " reported Dr. Deborah Phillips who conducted the survey. She concluded: "our nation's child care programs have fallen victim to a fabricated crisis."

Some insurance agents are informing consumer groups of their outrage over their companies' lockstep misbehavior. These agents resent being tarnished by underwriting practices they say they cannot control. Yet it is they who have to take the heat from the indignant policyholders.

Taming this inflationary and avaricious push on the insurance customer should not be difficult. Insurance Commissions need to use their existing authority to crack down on these rip-offs and compel the companies to disclose their line by line revenue, income and payouts. Congress needs to pass legislation providing for standby federal reinsurance that is self-financed by premiums and facilitating self-insurance to permit business and regular consumers to buy group liability policies in the auto, homeowner and business coverage areas. A Federal law is required because years ago the casualty insurance lobby passed prohibitions on such group policies (unlike group health and group life) in most states.

Finally, federal legislation removing the antitrust exemption from the insurance industry and regulating foreign offshore reinsurance companies like Lloyd's will bring the industry rapidly to its senses. All these reforms do not burden the budget; they will only stop the binge.

INSURERS MUST TAKE PART OF THE RAP

The U.S. insurance industry complains that its business has become too risky. Corporate directors, doctors, daycare centers, equipment makers, cities, and towns are among the diverse groups that are finding essential liability insurance prohibitively expensive or unavailable at any price. The insurance industry says this all adds up to a national insurance crisis, and it's right (page 88). The industry also charges that others—especially greedy lawyers, out-of-contol courts, and irresponsible juries—are to blame. While there is some truth to that, mainly the industry shot itself in the foot.

For many years, insurance carriers slashed premium prices and wrote as much insurance as they could get. Many companies abandoned traditional underwriting standards and competed fiercely for premium dollars they could invest in high-yield debt. This so-called cash-flow underwriting is probably responsible for most of the damage to company balance sheets today. The party ended when interest rates declined just as claims began to pour in.

With careful management, these mistakes can be corrected. But instead, the industry has spent most of its time and energy lately mobilizing attacks on the U.S. tort system. Admittedly, damage awards often seem excessive, though appellate courts frequently cut them back. But the industry's charge that more litigation and larger damage awards are the causes of its red ink is, at best, unproved.

The insurance industry has a point: It should not be asked to become society's deep pocket for new, poorly understood, and staggeringly costly risks, such as slowly developing environmental or workplace illnesses. For one thing, companies lack the actuarial experience to price such insurance properly. A new approach is needed. Already, as carriers withdraw from one kind of coverage after another, users have turned to various techniques to insure themselves. It is likely that the risks that society agrees must be insured will gradually be spread among insurance carriers, insurance users, and where appropriate, government. That is a better way to deal with liability claims than restricting the right of injured people to their day in court.

SPEEDWAY HAULERS, INC.,
South Bend, IN, February 17, 1986.

Mr. RALPH NADER,
Washington, DC.

DEAR SIR: Please let me participate in your campaign to call the present insurance emergency in America to the attention of the public.

I am in the trucking industry and (despite an excellent motor carrier safety record) absorbed a 150% increase in insurance rates at 1985 renewal, and have been advised to expect a 600% increase at renewal this year, if the markets we've approached agree to quote our coverage at all.

I am an excellent public speaker, and will invite opportunities to speak before the Public Service Commission of Indiana, the National Organization of Women Business Owners, various transportation groups, state legislative bodies, the American Trucking Association, the ICC, the D.O.T.—any one who will listen.

I'm advised that your staff has researched the issue of the insurance industry's "need" to increase rates, and hope that you will share your findings with me—that I (who believe in your mission) can participate immediately without having to repeat the research process.

Thank you. I hope that you will help me.

Sincerely,

JO ANN SAWYER,
President.

NATIONAL ASSOCIATION FOR THE EDUCATION
OF YOUNG CHILDREN,
Washington DC, January 20, 1986.

CHILD CARE INSURANCE CRISIS WORSENS

WASHINGTON, DC.—Parents can expect to pay more for child care as a result of "an unjustifiable insurance crisis that is jeopardizing child care throughout this country," according to a new report.

The study, by the National Association for the Education of Young Children (NAEYC), examined the effect of rising insurance rates and unprecedented cancellations on over 250 child care programs in 43 states.

Dr. Deborah Phillips, director of NAEYC's Child Care Information Service which conducted the survey, said the report shows that "our nation's child care programs have fallen victim to a fabricated crisis."

According to NAEYC's survey, an increasing share of the nation's child care programs are experiencing rate increases, cancellations, and nonrenewals of liability insurance, despite mounting evidence that child care poses no risk to the insurance industry.

The survey revealed that insurance cancellations and nonrenewals are affecting two-thirds of family day care homes and one-third of child care centers, up to three times the rate originally reported last summer.

Among programs still able to find liability insurance, 60 percent experienced rate increases during the last year. Over 50 percent are now paying at least twice their rate a year ago. Rate hikes of over 300 percent were not uncommon.

Contrary to the claims of insurance companies, "child care is not a risky business and insurers are not losing money on child care," said Phillips. "Our evidence suggests that these negative characterizations of child care are completely unfounded."

Nine out of ten child care programs surveyed had never had a claim on their liability policy. Of those with claims, 75 percent reported total claims under $500. The vast majority of claims were for minor injuries. The highest single claim was for $15,000. No claims resulted from child abuse allegations, frequently cited as the reason for the new crisis in child care insurance.

Phillips also dismissed insurers' allegations that companies needed higher premiums to cover losses. Payment on all claims reported by child care programs accounted for just 3 percent of premiums they paid during the past year, not taking investment income into account.

Other findings included:

Rate increases and nonrenewals showed no relation to the claims history of the child care programs. Some programs with claims experienced no changes in coverage, while many programs with no claims were cancelled.

Twenty-five percent of the programs reported that their liability coverage was narrower than it had been last year.

About half of all center-based programs and over one-third of family day care homes reported specific exclusions for claims arising from child abuse allegations. For one-quarter of these programs, this exclusion had been added within the last year.

Most of the programs surveyed reported plans to respond to the insurance crisis either by raising fees to parents or by cutting into their operating budget. Five percent of the programs were considering closing, and only 6 percent indicated that they would operate without insurance, which is frequently a condition of state licensing.

"What is really remarkable is that this survey demonstrates that child care is, in fact, a safe business and a sound insurance risk," said Marilyn Smith, executive director of NAEYC. "It is tragic that costs will rise and quality may deteriorate in some programs because dollars that could serve children are instead paying exorbitant and unjustified insurance premiums."

STATE OF NEW JERSEY,
DEPARTMENT OF INSURANCE,
Trenton, NJ.

STATEMENT OF IMMINENT PERIL

INSURANCE DIVISION OF ADMINISTRATION

Emergency adoption of new rules and concurrent proposal N.J.A.C. 11:1-20

The Department of Insurance is currently experiencing an increasing influx of consumer and agent complaints regarding indiscriminate cancellation, nonrenewal, premium increase and underwriting practices of commercial insurers. The actions complained of include mid-term cancellations, mid-term increases in premiums, failure to provide timely notice of nonrenewals and block cancellations and nonrenewals of entire lines of insurance. In addition, the Department, as well as affected public entities and others, have been notified by commercial insurers of their intentions to block nonrenew their clients' comprehensive general liability policies if the Department fails to approve a new commercial general liability policy form proposed by the Insurance Services Office, the largest rating organization in the State.

The property/casualty industry is presently attempting to recover from very serious problems caused by six consecutive years of increasing underwriting losses. The business is hurting because it underpriced its products, especially in casualty coverages.

Many industry advocates lay blame for the current crises in commercial property/casualty lines upon the tort law system and overly sympathetic judges and juries. They assert that it is impossible for companies to determine with any degree of certainty the maximum exposure they face on policies written due to the liabilities created by the Federal Superfund and New Jersey Spill Fund Acts and the courts' undue expansion of the common law liability of municipalities for environmental incidents and their concomitant disregard of contract provisions designed to provide insurers with coverage defenses.

Insurance company response to poor results has been to increase rates and reduce coverage substantially. This response is also in reaction to poor results experienced by reinsurers here and abroad who are withdrawing from the United States market. The end result is a capacity crunch.

As in previous "capacity crunch" incidents, the public suffers severe and economically debilitating dislocations. After a period of glut, when premiums drop to a fraction of their prior price levels, underwriting tightens like a vise and important major manufacturing and service industries find themselves unable to purchase insurance protection at any price from any company.

The insurers' actions in terminating existing coverage, refusing to renew expired policies and in dramatically increasing rates have led to an availability and affordability crisis in commercial lines insurance. Municipalities, environmental concerns, product manufacturers, medical professionals, transit authorities, nurse-midwives and day-care centers are among the hardest hit. Most of the affected professions and other entities cannot find coverage and if they are fortunate enough to do so, the cost is prohibitive.

The property/casualty industry asserts that its actions are necessary because of the financial harm caused by six years of overheated price competition during which rate adequacy and normal underwriting standards were sacrificed in order to maintain premium income. In support of its assertions the industry points to a 17.7 percent underwriting loss in 1984 and an 18.5 percent underwriting loss for the first six months of 1985. The industry contends that these results pose great dangers to the very solvency of an unacceptably large number of insurers. Advocates of the industry assert that it must improve its earnings if the industry is to maintain its current capital base and attract new capital to meet the insurance needs of a growing economy.

Although we agree that the industry's operating results has deteriorated for seven consecutive years, and that more disciplined underwriting along with adequate rates are needed, we see no justification for the rash of actions undertaken by the industry in terminating coverage prior to the expiration dates of policies and in increasing rates and reducing coverage in mid-term. The United States General Accounting Office in developing a financial overview of the property/casualty insurance industry found that for the 10-year period 1974 through 1983, the industry suffered about $28 billion in underwriting losses. However, for the same period, the industry had about $100 billion in investment gains, resulting in a total gain of about $72 billion for those years. Further, from 1974 through 1983, the industry paid only $1.3 billion in federal income taxes, about 2 percent of the industry's total gain for the period. While in past years investment gains have exceeded underwriting losses by a fairly wide margin, in more recent years the gap has narrowed. However, in every year, investment income has exceeded underwriting losses. Therefore, we should not permit the industry to abuse its policyholders as it implements new strategies to address its past mismanagement practices.

The data emanating from Wall Street tends to support this view. Property/casualty stocks have soared to record highs more than doubling the Dow Jones Industrial Average rise in 1985. Moreover, property/casualty stocks has historically outperformed the Dow Jones and other broad stock price indices, even in periods of adverse underwriting results.

Also, the A.M. Best Company (the leading financial analyst of the insurance industry) recently reported that the property/casualty industry has ample resources available to meet all contingencies. Best's found that the industry has liquid assets equal to 31 percent of liabilities and total unaffiliated investments exceeding liabilities by four percent.

While the property/casualty industry's profits were low last year and modest rate adjustments were expected, rates have skyrocketed. Instead of moderate rate increases, we see massive cancellations and mammoth price increases of up to 2000 percent for day-care centers, municipalities, transit authorities, truck and bus operators and others.

The Commissioner finds it necessary to adopt emergency rules restricting mid-term cancellations, mid-term price increases, prohibiting block cancellations and nonrenewals and requiring timely notice of non-renewals and cancellations in property/casualty commercial lines because failure to act promptly will result in serious harm to the insurance-buying public and the economic environment within the State. These techniques comprise some of the many steps insurers are taking in an effort to halt a competitive situation in commercial lines (and its related lack of regard for underwriting profit during the past several years) that has compromised the operating results of the industry. However, as the industry strives to return to a sounder financial footing, it should not abdicate its responsibilities. We are not insensitive to the industry's present condition and the critical need for corrective action; however, we observe that in many cases insurance companies have exceeded the boundaries of reasonableness in the conduct of their business and these activities must cease.

While we recognize that some premium increases, are perhaps justified, there is absolutely no reasonable excuse for mid-term cancellations unless on an individual basis as a result of unfavorable underwriting factors relating to the individual risk which were not present at the inception of the coverage. Moreover, unless a risk has developed an adverse loss history, it should be eligible for renewal under an insurer's current underwriting rules and rates. If a risk meets a company's underwriting standards at a "bargain basement" or even a "manual" premium when investment income is high and the physical nature of the risk itself does not change when investment income deteriorates, that risk should not be penalized by cancellation or non-renewal.

These are indeed distressing matters, which not only constitute unfair practices that are injurious to the public, but which also interrupt the free flow of commerce. Society cannot function properly when its commerce is so disrupted. The statutory responsibilities enjoins the insurance regulator to take agressive action to protect the interests of policyholders and the State, to the extent that insurance companies provide responsible, equitable and fair treatment to the insuring public. These emergency rules are being adopted to ensure that the insuring public receives treatment from their insurers that is consistent with the insurance laws of New Jersey. Delay in adopting rules fosters insecurity, distrust, unfair pricing and unavailability of insurance to magnitudes where the insurance buying public will be affected by extreme adversities.

HAZEL FRANK GLUCK.

INSURANCE COMPANIES MANUFACTURE "CRISES" TO BLOAT PROFITS

The insurance industry is gambling for high stakes. By massively canceling policies or refusing to sell coverage without 300 percent to 1,000 percent increases for many day care centers, nurse-midwives, transit authorities, physicians, municipalities, fishing fleets—to name a few sectors of the economy, the industry is betting that the resultant pressure will lead to the states granting it higher rates along with restrictions on injured peoples' right to sue. Where insurance companies are not abandoning these various markets, they are demanding staggering price increases—up to 1,000 percent for day care centers, for example.

There seems to be an underwriters' 10-year itch of greed operating here. Ten years ago, the companies bellowed about the "malpractice and product liability crises" and got higher premiums from the state authorities. Subsequent studies, including one by the U.S. Department of Commerce, revealed no such "crises" but the damage was done to consumers' pocketbooks and insurers' profits soared. Now, 10 years later, we are witnessing, in actuary, Robert Hunter's words, "a manufactured crisis intended to bloat insurer profits and reduce victim's rights." Already, in the first six months of 1985, auto insurance premiums have risen 9.1 percent, more than the rate of increase for all of 1984. At this rate, auto rates will rise 18.2 percent this year, far in excess of the increase in claims of inflation.

This "strike 'em or gouge 'em" gamble may just backfire. Americans do not like companies who refuse to sell to them, or who refuse to sell to them unless they get three or five or 10 times the previous price. Such business behavior turns people off. If the insurance industry is selectively going on strike, or abandoning certain markets or imposing wildly extortionate prices, then federal or even state government pools of insurance can be established to provide coverage for people who lose coverage through no fault of their own. Insurance is a necessity and if the companies do not want the business, those businesses affected simply cannot be required to close down. When those same insurers refused to offer insurance to properties in the center cities during the disruptions of the 1960's, the federal government offered the FAIR plans that kept insurance available in these cities. The government made money in this business contrary to insurance industry predictions.

The Government has offered in the past many kinds of insurance where private insurers have balked—crop insurance for farmers, bank deposit insurance for savings accounts and for some years flood insurance for properties on flood plains. Furthermore, federal law has facilitated self-insurance pools for companies who want to get together for coverage in product liability areas. So the insurance industry is gambling with the risk of inviting Uncle Sam and self-insurance by syndicates of their former business customers.

Leaders in the industry think they will win. Here are the words of John J. Byrne, chairman of the GEICO Insurance Co: "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures." Instead of this massive industry using its leverage to advance pollution cleanup, safer consumer products and workplaces, it is, with few exceptions, behaving like a spoiled brat. For example, *Engineering Times* reports that the main underwriters for the 11,000 architectural/engineering firms will include a "pollution exclusion" in all future policies. This means that firms working on municipal treatment plants or projects involving emissions or recycling, reconditioning or reclaiming waste products won't have insurance for these activities.

The insurance companies are using judges and juries as their favorite whipping boys, blaming verdicts and settlements for their troubles. If that is the case, why are casualty insurance company stocks selling at record prices on the stock exchanges? Why are stock brokers recommending to investors that these companies are great buys? Robert Hunter president of the National Insurance Consumer Organization (344 Commerce St., Alexandria, VA 22314) will send interested readers a factual refutation of the casualty insurance industry's contrived woes. Please include a large self-addressed, stamped envelope with 44 cents postage.

It will take an informed citizenry and an informed media to stop the great insurance industry boycott of 1985. And investigations by Congressional committees and the Justice Department will accelerate the exposure of this concerted over-reaching by these companies.

BETTER POLICING COULD STEM MEDICAL MALPRACTICE INSURANCE CRISIS

The every 10-years malpractice insurance crisis is off and running. Insurance companies are canceling policies for some specialists or raising their premium two, three-, four- even six-fold. One Maryland physician, with a clean record, saw his insurance bill this year go from $6,000 to more than $40,000. Physicians in some states, such as New York, have marched on state legislatures demanding that victims of malpractice be restricted both in their rights to sue and in how much they can recover.

Yet when one looks at the data, the overwhelming causes of the malpractice insurance crisis are (1) malpractice, (2) poor underwriting practices by insurance companies and (3) very weak disciplining of incompetent or negligent physicians by hospitals, medical societies, state licensing boards and federal peer review agencies.

Several medical groups have estimated that, of the 400,000 practicing doctors in the United States, anywhere from 20,000 to 55,000 of these people are either alcoholics, drug addicts, mentally ill, infirm or grossly incompetent. Last year, it took the U.S. Postal Service to uncover the fact that more than 2,000 individuals were working as physicians after buying phony medical degrees through the mails. Neither state regulatory agencies nor the self-policing units of the medical profession found them.

Medical licensing boards in the 50 states and the District of Columbia revoked, suspended or put on probation only 563 doctors in 1983. New York, with the biggest increase in malpractice premiums, has one of the lowest rates of doctor discipline in the United States—1/10th of the rate of disciplinary actions in Utah. Although malpractice verdicts and settlements amount to less than 1 percent of the nation's total health bill, malpractice produces other costs such as more hospital stays, rehabilitation services and disability payments.

Instead of cracking down on medical incompetents, state medical societies and their lobbyists have declared war on malpractice victims and their lawyers. Instead of moving to spotlight and remove the bad actors in their profession, competent physicians allow themselves to be dunned for legislative warchests to reduce victims rights.

Dr. Sidney Wolfe, director of Public Citizen's Health Research Group asks: "Why should the many excellent physicians who have not had adverse malpractice adjudications or settlements against them have to subsidize the premiums of their less competent colleagues who now pay the same as they? There is a tremendous and dangerous gap between the amount of malpractice—negligent doctor behavior resulting in injury or death—and the amount of doctor discipline."

Far more malpractice cases occur than ever reach the lawyers. In one California study, only one in 10 cases of malpractice occurring to people inside hospitals in which the patient would probably prevail, are actually brought to litigation. Based on 1984 data from the American Medical Association (which at last wants to get tougher on bad physicians), there were about 16,400 patient awards or settlements in malpractice suits. It is also not easy, by the way, for an injured plaintiff to win a case in court against a physician, statistics show.

One woman in a small town in Oklahoma found she could not obtain services from physicians in the area because they learned that she was seeking legal advice in a malpractice claim against one of their colleagues in Mississippi, the Professional Review Organization (PRO) found that in 1983 doctors in that state performed 35 "inappropriate" leg amputations on Medicare patients. And there are unfortunately all too many reports of similar horror stories elsewhere.

What can be done about the incompetent doctor? Dr. Wolfe recommends the following:

Pass stronger legislation in states to expand the size and strength of the licensing (doctor discipline) function.

Raise the annual license fee for doctors and use the revenues to improve the monitoring and evaluation of physician competence.

Insurance companies should experience-rate doctors so the good doctors stop subsidizing the ones with worse performance records.

Require attorneys to turn over to state licensing boards information about doctors after patients prevail in a malpractice suit. Now, the terms of settlement by the defendant and his/her insurance company often prevent the transfer of this information.

Require other data, such as those collected by PROs, be made part of doctors' files in the state licensing bureaus.

Require periodic and thorough recertification of doctors.

Over the next 12 months, the physicians' and insurance lobbies will be all over the state legislatures to curtail victims' rights to sue and obtain an adequate award. These lobbies are recklessly going after symptoms, when the disease is the gross lack of disciplinary action against those physicians who should not be practicing medicine at all.

INSURANCE COMPANIES CRY "WOLF"

(By Ralph Nader)

It is doubtful whether there has been anything like the present insurance industry's commercial-liability price spiral in American economic history. If you think your auto insurance policy premium is going up fast, take a look at what these policyholders are going through.

Kopetz Inc., a plate fabricator in Decutur, IL, was rewarded for never having a single claim on their liability insurance coverage by an insurance bill nearly six times that of 1980.

Lane Groff, president of the Carolina Fire Equipment Company of Greenville, S.C., has never had a liability claim paid in more than 20 years. His business has just been canceled by his insurer with less than two months notice.

Housing authorities in New York state were faced with an increase in liability insurance premiums from $7.56 per dwelling unit three years ago to $123.00 per dwelling unit this year. In Boston, public housing authorities found their master policies canceled with the new policies up 280 percent for half the coverage.

Southwest Tank Liners, in El Centro, CA, preventive maintenance service for underground storage and water tanks, collected $4,000 in claims over four years. In one year its liability insurance policy went from $17,000 to $75,000 a year.

These businesses are the lucky ones, compared with firms engaged in asbestos removal, pollution cleanup for industries and municipalities, commercial fishing boats, mass transit systems and local governments and school boards that are increasingly unable to obtain coverage at any price.

What's going on here in the past few months? A lot of unanswered questions by the insurance companies, that's what. Why, for example, don't the insurance companies disclose the sum of all verdicts and settlements paid out and subtract the amount from their premium and investment income, if they want to back up their wild alarms with facts? Why do the insurance trade associations always tell the press how much premium income losses they have, without adding back their investment income gains?

If they did, their allegedly big loss in 1984 would have turned out to have been a 3 percent return on net worth, even accepting their inflated reserve increases for future liabilities. If their premiums were just 5 percent higher, the property-casualty insurance industry would have earned a comfortable rate of return on net worth of about 15 percent. But instead we are seeing increases of 200 to 500 percent for day-care centers, if they can get it, 300 percent to 1,000 percent increases for public transit authorites and so on ad nauseum.

What is also going on is that the casualty insurance industry is bent on manufacturing a crisis to achieve two goals. One is to stampede legislators into restricting your right to sue to compensate for your injuries and damage. The other is to push the pathetic state insurance regulators into approving higher premiums.

Of course, shakedown premiums are more than a matter of policyholders having to shell out vast sums of money. Many of these small businesses will have to close down; schools will curtail some of their extracurricular sports and other activities, cancer-producing toxic wastes won't be cleaned up; negligent or culpable companies will get away without being made to pay for their harm under weaker personal injury laws.

All these consequences and more will be the pattern of the near future unless the people call the insurance moguls' bluff in four ways.

First, those businesses that can get together and self-insure should do so, thereby freezing out the greedy insurers.

Second, the business and professional community—lots of clout there—should demand that Congress pass federal reinsurance programs, as it did in past years for flood and center city insurance. The government made a small profit on these reinsurance services.

Third, both houses of Congress should initiate major investigations. These investigations should highlight the real agenda of this industry, expose how little safety muscle it is applying for injury loss prevention, and make a strong case for repealing a 40-year old law that exempts the insurance business from federal anti-monopoly action.

Fourth, if you have been unjustly treated or canceled by an insurance company, write the details to your representative in Congress and send a copy to the National Insurance Consumer Organization, 121 North Payne St., Alexandria, VA 22314. Once again, the spark for public justice is struck by your letter and demands.

INSURERS: SACRED COWS FEEDING NOT-SO-SACRED BULL

Last year, the nation's liability insurance companies increased their premiums by another $25 billion—the equivalent of $100 for every man, woman and child in the country.

On the New York Stock Exchange, the shares of these property casualty companies rose by 50 percent, nearly twice the rise, of the Dow Jones Index. And Wall Street is expecting sharply rising profits for the rest of the decade.

In the same year, this industry arbitrarily canceled the insurance converage of thousands of businesses ranging from small trucking firms and manufacturers to fishing boat operators to day care centers, as well as municipalities housing authorities and mass transit companies.

Even the tram operator who has carried tourists up Mount Rushmore for 30 years without a claim saw his policy canceled. For others still able to obtain coverage, premiums have skyrocketed 300, 600, 800, or even 1,000 percent.

Insurance is supposed to facilitate commerce, but now it is undermining or obstructing commerce.

For 1986, more of the same is expected by insurance industry observers. Protest letters from small business people are pouring into our offices and those of the National Insurance Consumer Organization, a public interest group headquartered in Alexandria.

One letter came from Connecticut Businessman Robert Johnson who invented a tree-pruning device. In the '70s, he built a small company that sells the product to Sears Roebuck & Co.

"I have lived the American dream" he wrote me. Not a single claim has ever been filed against Johnson's firm.

Suddenly, last December, his insurance company canceled his product liability policy—after tripling his premium in just four years.

Johnson was faced with a shutdown of his business because Sears would not buy his product without such coverage. I called the president of Johnson's insurance company in Chicago. The receptionist said he was in conference and would call back. Two hours later an elated Johnson called me instead to say the company had renewed his policy.

The point of this story is that actuarial data or loss claims experience has become irrelevant to the "strike 'em or gouge 'em" practices of the insurance companies who are bent on bloating their profits and manufacturing a crisis to stampede legislators into restricting the legal rights of injured people.

According to the Institute for Civil Justice, the size of jury awards and the number of lawsuits has barely kept even with inflation and the population increase since 1960.

The insurance industry, however, ignores these statistics and repeats a few tired case anecdotes in a highly distorted context.

In response to the liability insurance industry's cyclical behavior—every 10 years its behavior goes wild with cancellations and rip-offs—people need to learn more about the amazingly privileged position of these companies.

Sample the following, if you will:

The insurance industry lobby has pushed through laws that exempt it from antitrust laws and federal regulation.

The foreign re-insurance giants, such as Lloyd's of London which demand that domestic insurance companies engage in anti-consumer practices are not regulated by the states or the federal government.

The United States, which has half the world's insurance market, is still dependent on these foreign re-insurance companies, who want to reduce the rights of injured Americans to the lowest West European denominator.

Many years ago, the property-casualty industry obtained state legislation prohibiting both businesses and consumers from banding together to purchase group liability policies, as they can do for group health and life insurance.

The provisions of the federal income tax code dealing with insurance are a dream come true for the industry.

According to the General Accounting Office the watchdog arm of the Congress property-casualty companies as a whole earned a profit of $750 billion during the period 1975–1980 but paid no federal income tax.

For many insurance companies technical jargon and obscure accounting have become a shield against accountability. For too long, this industry has been a sacred cow feeding the public a lot of not-so-sacred bull.

A CANADIAN LESSON: STOP INSURANCE INDUSTRY'S GOUGING

By engaging in massive premium gouging, arbitrary cancellations and reduced coverage, the liability insurance industry is trying to enlist legions of panicking small businessses, city governments and professional firms in its drive to pressure legislators to restrict the rights of injured people to sue for damages. Obviously manufacturers in the auto, drug, chemical and other industries, who have been taken to court for their defective or toxic products, are joining in the hoopla to place obstacles in the courtroom door and inside the courtroom for regular citizens.

This is not a poor insurance industry. Its profits are soaring. Its stocks on the New York Stock Exchange boomed by 50 percent in 1985, double that of the Dow Jones Index. As a whole, these companies have made more than $70 billion in the last 10 years according to the General Accounting Office, and paid negative federal income tax. Nonetheless, its trade associations and company lobbyists are pushing for what they call "reform of the civil justice system."

Only by accepting these restrictions on injured or sick victims rights against perpetrators of their harm in industry and commerce, the casualty insurers say, will rates and coverage become reasonable again.

Well let's see. North of the United States is a land called Canada. For decades, the province of Ontario which has more than one-third of the country's population, has had the so-called "reforms" that the U.S. insurance industry wants to have imposed on our country. In Ontario, punitive damages against companies in tort cases are almost impossible for plaintiffs to obtain. Contingent fees, where your lawyer takes the cases, must pay the defendants attorneys' fees as well as their own—a major impediment to using the courts. There are severe caps on recovering for pain and suffering.

Also in Ontario there are restrictions on the jury's role and most trials are conducted by the judge without jury. There is no constitutional right, as there is in our country, of a right to a jury trial in such personal injury cases.

So you would expect that the casualty insurance industry would be behaving in Canada, providing businesses with fair, adequate and non-discriminatory coverage. Well, you should see the headlines in the Ontario newspaper these days. It is as if you never left the United States—for the insurance industry is raising premiums in various sectors by 400 percent, cancelling coverage in mid-term and, in increasing instances, refusing to provide coverage at any price. Maybe they want to drive Canadian law, now below that of the United States in this personal injury area, to the lowest Korean denominator.

Specifically, the insurance industry has gouged or canceled day care centers mercilessly. The same treatment is being given school boards. The insurance companies are turning their backs on liability insurance for Toronto and many other cities. Premiums have gone up 1,000 percent, with reduced coverage, for the Ontario intercity bus industry. Hospitals in Toronto can still get insurance, but only at "greatly increased" premiums.

Government officials in Canada are outraged and are blaming some of the problem on foreign reinsurance firms like Lloyd's of London, which is pulling the strings on domestic insurance companies in Canada. These officials are demanding that the federal government in Ottawa establish a reinsurance company.

Whatever the turn of the events in Canada that country's experience demonstrates that even if the insurance industry gets away with undermining victims' rights in the United States, the avariciousness and power plays will continue to come from their executive suites unless there is a business revolt against such transparent manipulation.

Chairman **Pickle**. Now we will ask Mr. Melvin Belli to proceed. You might introduce the gentleman at the table with you.

STATEMENT OF MELVIN BELLI, ATTORNEY, SAN FRANCISCO, CA, ACCOMPANIED BY CEASER BELLI

Mr. **Belli**. Thank you.

This is Ceaser Belli, my son, who has just joined the firm and is also concerned about getting insurance. I have got to have him have insurance, too.

Chairman **Pickle**. Glad to have you both here.

Mr. **Belli**. Thank you.

May it please you, Mr. Chairman and gentlemen, I think first before we determine what we are going to do about the disease, we better find out whether there is a disease, whether there is an insurance crisis or whether there is a big conspiracy and a big hoax that is looking forward to making more profits in the insurance industry.

I might start in with a personal reference that I don't have insurance; Ceaser doesn't have insurance. We can't get insurance for our boat which is about 50 years old, not quite as old as I.

I don't know whether it is age they won't give me insurance, but what they said they would give me $1 million of insurance for a $600,000 premium.

Now, the things that are being asked for before the Congress and the various legislatures, such as reform of the tort system, I see in the papers all over the country.

Here is the St. Louis Post Dispatch, "Time to Re-Examine the Tort System." Then the same thing in the Tulsa World, the same thing in the San Francisco Chronical, all over the United States, is being orchestrated that this catastrophe, that we have got to do several things.

We have got to change our good tort system. We are not, I think, in the golden age of the tort system. We either go along to the platinum or go back to the leaden at the time that I came to the bar over 50 years ago.

I think we better find out first, though, whether there is a catastrophe that the insurance companies are not making profit.

Now, that is a simple thing to do. I read in the paper the other day that in a recent report filed by the U.S. General Accounting Office, the casualty industry in the 10 years since the start of the so-called malpractice crisis made $72 billion in 10 years.

Now, they either did or they didn't. You can't hide $72 billion unless you are Marcos. But the $72 billion should be able to be determined awfully fast. I think that is where we start from.

That is why I would like to refer this honorable body to a bill that was just passed 39 to 2 in the Oklahoma Senate.

I think this is where we start from to determine what disease we have got, and then do we go to surgery, do we go to antibiotics, or where.

If the insurance company isn't making money, as the author of the "Adequate Award" in the California Law Review about 30 years ago, I would be the first one to say, let's raise their premiums. Let's do something to help the poor people out. If they really need to make money we will help them out, and I might even join the other side.

But I don't think that they need to make any more money than they are at the present time. The best way to find out is to go to the source of this article that I just quoted here, the General Accounting Office, and see if the casualty industry has made $72 billion in the last 10 years.

Now, this is what happened in Oklahoma, and this is where I say, start. We had this same alleged crisis, which is a hoax and a conspiracy, back in California a number of years ago.

It started in California. We have got a good tort law in California. Pat Brown, when he was Governor, and he was a good tort lawyer, and I tried to find out whether the insurance companies really were making money, whether they were losing money.

We couldn't find out the first penny. We couldn't find out any figures, any statistics, whether they were losing or whether they were making it.

Now, gee, if you are selling some goods, you ought to display the goods. If you are losing money, and if you are coming before an objective body and you want to tell them that they need more money, that you just can't stay in business, and an absolutely necessary industry that has been impressed with the public interest—gee, you ought to be able to show it.

This is what Oklahoma did, and this is what I think we ought to do. Senator Taylor, the bill's author, said he devised it after he failed to receive a single response from insurance companies that had been asked to submit financial information on claims and premium rates.

That is the same all over the country. Taylor said he sent out 200 questionnaires, but that not one company responded with the requested information.

There is a conspiracy of silence among the insurance companies, he charged. Taylor said it is impossible to get a true picture without the necessary financial information. And it is impossible for us to determine what we can do to help these poor people. I use that term advisedly according to them, unless we find out what they are suffering from.

His bill requires detailed reporting by insurance companies on claims against them, premiums collected and fees that they pay their attorney.

Now, if they are losing money, gee, they ought to be the first ones to come running in and showing how much they are losing, to show these figures of the $72 billion by the General Accounting Office are false, or they are trying to perpetrate the greatest hoax that I have ever seen try to be perpetrated on this Congress and the American people.

Not only that, but they want to change the whole good tort system. I remember—I am not quite that old, but I remember seeing the flag of one of the 13 original colonies that had a rattlesnake coiled on it with the legend, "Don't Tread on Me."

I think our tort law is one of the things that gives us this great life, freedom from harm, freedom of harassment, freedom from worry in this country.

Now, the insurance companies say there are more and variegated plaintiffs, more and variegated torts, and that we are suing for too many things.

But gee, I think that is what we need, to have an open court to be able to sue for anything that a man thinks he is being harassed with, whether it is a quadriplegia or whether it is finding a rock in a can of beans.

You find a rock in a can of beans and you sue for something like that up in Portland, ME, maybe a nuisance suit up there, but by golly, that same company, Del Monte or whoever it is, will see that that can of beans is safe down in San Diego.

I think the lesson learned in our tort system is what makes this country great. I don't want to change this tort system we have got at the present time.

I practiced it for 50 years. I have seen it do a lot of great things. I have seen our tort law change, and as I say, I think we are in the golden age of it. I think we are going to go beyond that, and I think we are going to get into the platinum age when the lawyers with their contingencies get sentenced and cut their fees down.

When I came to practice some 50 years ago, lawyers were charging 50 percent. They went to 40, then down to 30. Now they are down to 25, and even less than 25 percent.

We are cutting our fees down. We are cutting down the length of time that it gets to trial. We are using arbitration. We are using pretrial settlement. We are doing a lot of things.

I think our judges are more learned. I think our judges are better. I think the judges are sincere, and if the awards are too high the judges cut them down.

Now, that is a lot of false fact, that we have got to get rid of punitive damages. In 50 years, I think I have gotten as many awards, and I have tried as many or more cases than any American lawyer, particularly on the civil side, and I have only had about three, at the most, punitive damages, but I think punitive damages are necessary.

I remember a punitive damage case down in Santa Anna that went for $125-million punitive damages. And why? Because there was introduced in evidence a memo to the Board of Directors by the Safety Department of Ford that there was something wrong with the car that caused a lot of accidents and dangers, but it was cheaper to go before juries than to recall the cars and fix that.

That was given to the jury. When the jury saw that, they said, well, fix them. Well, make their cars safe. And they gave a $125 million punitive damages award.

That was set aside upstairs down to a $5 million award, but it had its effect. It had its effect, and boy, they recalled those cars, and they didn't submit them to the jury again, because they knew if they did, that would stick.

Well, I think the most important thing that I can think of is that we find out what the disease is. Is it AIDS? Is it pneumonia? Is it appendicitis, or what? We find out whether these people are really losing money.

Oklahoma hit the nail on the head, their Senate, when they said, let's pass a bill that this is impressed with the public interest, like the public utility companies and these people, if they want to get higher rates for something that is impressed with the public interest, let them come in like the gas companies do, like the telephone companies do, and show that they need actually more money to stay in business.

Now, all of this changing of the tort system that I don't want to see done, all of these years it took us to build up a good tort system, they changed all that up in Canada.

They have a cap on verdicts. They have got no contingencies. The judge says to the jury, I think that this is too complicated for you. It is a medical malpractice case. I am going to send you home, and I am going to decide it myself.

They have done all of the things that the insurance companies want to be done in this country. What has happened? Have the rates gone down as they said that they would if they changed the tort system in Canada?

Here is just a couple of illustrations. In St. Louis, New Brunswick, the zoo, the premium raised just the other day from $600 a year to $9,000 a year.

In Ottawa, the St. Johns ambulance, the premiums went from $16,000 to $250,000.

Now, they got a change of the tort system there, and look what happened to the premiums. This is a matter of 1 and 1, 3 and 3. This is something that doesn't need rhetoric, doesn't need emotion, doesn't need any slight of hand, doesn't need anything under the handkerchief.

All we need is the figures. Show us the figures that you would be losing money, and by golly, I will be the first one to say, raise the premiums.

But gee, don't come in and tell us all of this stuff and in the face of the figures from the Accounting Office and the rest of it that we know are actually not so.

I am going to try and submit something a little later about how they want to change the tort system. I don't know why they want to do it, but they want to change the contingent fee. They want to change trial by jury. They want to bring consumer cases into Federal courts, out-of-the-State courts.

They want to get rid of trial by jury. That is from Justice Burger on down. They feel we don't need trial by jury; we need something like they have in New Zealand.

I say our system is good. I say our system is great. I say our system is in the spirit of that original colony that had the rattlesnake and the flag, "Don't Tread on Me."

You get rid of our tort lawyers—and I am proud to be one—and I think in the 50 years that I have been at the practice I have done something for the little guy. I have done something for my fellow man.

And I would hate to see it go down the drain, particularly when the lead is being taken by the insurance company and not by the law professors or not by the legislature.

Thank you very much.

Chairman PICKLE. We thank you, Mr. Belli, for your testimony. Now, we will ask Mr. Civiletti to proceed.

STATEMENT OF HON. BENJAMIN R. CIVILETTI, GENERAL COUNSEL, AMERICAN TORT REFORM ASSOCIATION, AND FORMER U.S. ATTORNEY GENERAL

Mr. CIVILETTI. Thank you, Mr. Chairman and members of the committee.

I am a trial lawyer, and I am also general counsel for the American Tort Reform Association. I have been involved in trying cases on the plantiffs' side, but primarily as defense counsel, and I believe, like many other participants in such cases, that we do need to reform our tort system.

Torts history serve two purposes: First, to provide timely and reasonable compensation to those who are wrongfully injured by others; and second, to deter wrongful conduct.

Today, sadly, the system serves neither purpose well. The current system is characterized by needless delay, terrifying costs to both plaintiffs and defendants.

It imposes random liability and leaves some injured without any help. It has limited, certainly, and in some cases eliminated, the availability of insurance.

ATRA is an interesting phenomenon in and of itself. I think it is one of the signs of a growing consensus that the tort reform time has come.

ATRA is a coalition of organizations whose purpose is to study and formulate and remedy forms of our tort system. It started in January of 1986, but already over 150 organizations joined in the coalition. Its charter members include many professional organizations and trained groups which represent over a million businesses, professions, schools, communities, partnerships, public utilities, and consumers.

It only has one commitment, the need to serve the current liability crisis, and to assure access to adequate, affordable and necessary insurance, but at the same time to assure fair and reasonable and timely compensation to the victims of wrongful conduct.

We recognize that responsible action must be taken to reduce the occurrence of wrongful conduct and at the same time to preserve access to our courts.

As the law originally developed, an injured party could be indemnified for his or her injuries in a tort action only when it was traced to fault.

I think one of the primary difficulties with the present tort system is that we are far removed from a system based on responsibility or fault for compensation.

Justice Oliver Wendell Holmes explained in his classic work, "The Common Law," the tort system is based on the premise that a person should be given "a fair chance to avoid doing the harm before he is held responsible for it."

Our system, I am afraid, has abandoned the fault principle responsibility in favor of a broad variety of substitutes for fault.

One part of this variety is the expansion of strict liability principles which allow recovery where a party's injuries are related to another but where the other party had no fair chance to avoid doing the harm.

There are countless examples of the extreme reach of strict liability doctrines. It seems one simple approach in the law would be to return strict liability to its original purpose—extraordinarily dangerous circumstances.

At the other end of the spectrum, we must consider alternative means for assuring appropriate compensation of victims of certain injuries who now and otherwise may suffer unfair loss under a strict fault based system.

Consideration of alternative approaches is a compelling subject for Congress and for State legislative action.

At the turn of the century, we had a tort system based primarily on the fault principle. Congress and the State legislatures adopted workers' compensation statutes, where necessary, to require employers to compensate workers for job related injuries without regard to fault, and that was a compensation reform.

More recently, Congress has determined without regard to fault that governments should bear the reasonable cost of injuries in such circumstances and laws as the Swine Flu Immunization Act of 1976 and the Teton Dam Act of 1976.

There are lots of theories and opinions on why we have a liability crisis. There are harsh allegations against lawyers and courts and insurance companies and other corporations.

I can't determine the parsing of those responsibilities and those allegations, but what I can suggest is that there are overburdened courts; there are unconscionable verdicts, and there are certain reforms which may be seriously considered.

One is joint and several liability. There is now a deep-pocket theory that instead of suing those who are at fault, if anyone is involved in the circle of responsibility, sue the party with the deep pocket.

With the loss of immunization by State and local governments, that frequently is a governmental body. One suit is brought against the governmental body with no other defendants, and even though their responsibility may be 1 or 2 or 5 percent of the harm causes, they are left with the entire amount of damages.

We should return to the fault principle with regard to joint and several liability and apportion the responsibility for the damages or injuries incurred accordingly.

Another rule which has developed and now extended with multiple insurance and multiple payments—not unlike the dipping rule—is the collateral source rule relating to damages.

When juries calculate damages, they do not know and cannot calculate double benefits the plaintiff may receive as a result of injury, such as duplicate insurance payments or workman's compensation payments.

The collateral source rule prohibits the defendants from offering this evidence to the jury, thereby allowing the plaintiff to recover either double or sometimes triple amounts over and above the award for injuries which would be determined to be justified by the jury based on the loss suffered.

Several studies have recommended that this rule be eliminated entirely. A report by the American Legislative Exchange Council states that in studies prepared by the ABA and the Rand Corp., the elimination of the collateral source rule alone could reduce court awards between 18 and 20 percent.

Another reform whose time has come is the alternative dispute resolution. Such alternatives include arbitration, mediation, best witness presentations, mini-trials, and pretrial hearings to assist the parties in reaching a resolution.

These avenues are used regularly and successfully to resolve labor management and Government contract disputes and to settle small claims. They can be used regularly and successfully in tort litigation.

Generally, one of the key issues for any reform of the tort system and its relationship to economic harm and insurance is the burden carried by those who must pay—ultimately the public—for large injury awards or damages.

Elements of damages have been parsed and cut and reparsed in order to multiply damage calculations for one single basic injury.

Serious thought must be given to the wisdom of uncontrolled awards for pain and suffering, mental anguish and punitive damages.

I agree with Mr. Belli that the number of punitive damages—the actual awards that are recovered—which survive either motions to reduce them or appellate processes, is small.

If we were concerned only with the awards themselves, I don't think there would be sufficient justification for revision of that part of the tort system.

But, in effect, what happens, and the real threat of punitive damages, is that they are like playing poker with a wild card where one of the card players has not one wild card but two wild cards.

The possibility of punitive damages is the one wild card, and the unlimited and uncontrolled pain and suffering or mental anguish is the second wild card.

Since they are both unpredictable, the card player without those two cards is at a substantial disadvantage. Any carrier trying to predict risk, loss of risk, and, therefore, reasonable premiums in regard to anticipated loss, is at the same disadvantage that the non-wild card poker player would be in a game of tort poker.

The liability crisis is real; it is wide; it is deep, and it will worsen unless fundamental changes are made. I have identified a few methods of reform. They are not the only ones, but it is time not for the courts to deal with these on a piecemeal basis, case by case, but for legislative bodies to direct and lead a fundamental reassessment of the basic values and goals for the civil tort system.

Legislative bodies and not the courts have the power and authority and the wisdom and capacity to end the liability crisis and restore the public satisfaction and confidence in a fair and just tort system.

I applaud the subcommittee and its chairman for this hearing, and I look forward to the coming of a brighter and better day for our tort system and for our country.

Thank you.

Chairman PICKLE. Thank you, Mr. Civiletti. We appreciate your testimony.

[The prepared statement follows:]

STATEMENT OF BENJAMIN R. CIVILETTI, GENERAL COUNSEL OF THE AMERICAN TORT REFORM ASSOCIATION [ATRA]

Mr. Chairman, and members of the subcommittee, I am Benjamin R. Civiletti, partner in the law firm of Venable, Baetjer, Howard & Civiletti. I am a trial lawyer and the General Counsel of the American Tort Reform Association (ATRA). I appreciate the opportunity to testify before you today.

Mr. Chairman, I have been involved in many tort cases, as plantiff's counsel and primarily as defense counsel, and like many others who have been participants in such cases, I believe that we must reform our tort system. Historically, the tort system served two purposes. First, it provided timely and reasonable compensation to those who were wrongfully injured by others. Second, it served as a deterrent to such wrongful conduct. Today, sadly, the system serves neither purpose well. The current system is characterized by needless delay and terrifying cost. It imposes random liability and leaves some injured without help. It has limited, and in some cases eliminated, the availability of insurance.

The organization that I represent—ATRA— is but one of many signs of the growing public consensus that the time for tort reform has come. ATRA is a coalition or organizations whose purpose is to study, formulate and recommend reforms to our tort system. ATRA only started in January of 1986 but already over 150 organizations have joined our coalition. ATRA's charter members include many professional organizations and trade associations which represent almost 1,000,000 businesses, professionals, schools, communities, partnerships, public utilities, and consumers.

The common interest of ATRA members is the need to solve the current liability crisis, to assure access to adequate affordable and necessary insurance, and at the same time to assure fair, reasonable and timely compensation to victims of wrongful conduct. In seeking tort reforms, ATRA is well aware of the need for responsible action to reduce the occurrence of wrongful conduct and to preserve access to our courts.

RESTORATION OF A FAULT-BASED SYSTEM OF TORTS

As the law originally developed, an injured party could be indemnified for his or her injuries in a tort action only when that injury could be reasonably traced to the fault of the person sued. As Justice Oliver Wendell Holmes explained in his classic work, "The Common Law," the tort system is based on the premise that a person should be given "a fair chance to avoid doing the harm before he is held responsible for it". In recent years, our law has abandoned the fault principle of responsibility in favor of a broad variety of substitutes for fault. This approach is exemplified by the expansion of strict liability principles which allow recovery where a party's injury is related to another but where the other party had no "fair chance to avoid doing the harm". There are countless examples of the extreme reach of strict liability doctrines. I believe we must limit strict liability to its original purpose—extraordinarily dangerous circumstances.

At the same time at the other end of the spectrum we must consider alternate means for assuring appropriate compensation of victims of certain injuries who might otherwise suffer unfair loss under a fault-based system.

Consideration of such alternative approaches is a compelling subject for congressional and state legislative action. At the turn of the century, when we had a tort system based on the fault principle, Congress and the state legislatures adopted workers' compensation statutes to require employers to compensate workers for job-related injuries without reference to fault. Under workers' compensation laws, a worker need only show that he or she was injured by an accident while acting within the course or scope of his employment. Recently, Congress has adopted a number of laws allowing compensation for injuries on a similar strict liability theory where the injuries resulted from desirable or necessary activity and where Congress determined that the government should bear the reasonable cost of the injuries. One such law was the Swine Flu Immunization Act of 1976 and another was the Teton Dam Act of 1976.

NEEDED REFORMS

There are numerous theories and opinions on why we have a liability crisis. There are harsh allegations against lawyers, courts, insurance firms and other corporations. I am not here today to help ascertain why we have ridiculous costs, overburdened courts and unconscionable verdicts. Rather, I want to discuss a few specific areas in which reform is needed.

A. *Joint and several liability:* Joint and several liability means that when two or more defendants cause an injury to a single plaintiff, each defendant is liable—separately and together—for paying the plaintiff's damages. Because the entire liability can be imposed on any one defendant, a plaintiff will often seek redress from the most solvent defendant only—"the deepest pocket"—and not from the defendant most at fault. This has resulted in one defendant being held responsible for the entire judgment, regardless of the degree of fault or the plaintiff's contributing negligence. We should return to the fault principle and apportion responsibility accordingly.

B. *Collateral source rule:* The collateral source rule is one of many damage exaggerations that provide compensation beyond the cost of a plaintiff's actual injury. When juries calculate damages they do not know and cannot calculate double benefits the plaintiff may receive as a result of injury, such as duplicate insurance payments or workers' compensation payments. The collateral source rule prohibits the defendants from offering this evidence to the jury, thereby allowing the plaintiff to recover double amounts over and above the award for injuries determined to be just by the jury.

Several studies have recommended this rule be eliminated. A report by the American Legislative Exchange Council states that in studies prepared by the American Bar Association and the Rand Corporation, the elimination of the collateral source rule alone could reduce court awards between eighteen and twenty percent.

C. *Alternative dispute resolution:* We must consider the numerous alternatives to litigation as part of a broader effort to reduce the so-called "transaction" costs of the tort system. Such alternatives to litigation include arbitration, mediation, best witness presentations, mini-trials, and pre-trial hearings to assist the parties in reaching resolution. These avenues are used regularly and successfully to resolve labor-management and government contract claim disputes, and to settle small claims. They can be used regularly and successfully in tort litigation generally.

DAMAGES

Reforms in our tort system must deal with the inflation of damages far beyond just compensation for the actual cost of the injury. Elements of damages have parsed and reparsed to multiply damage calculation for one basic injury. Serious thought must be given to the wisdom of uncontrolled awards for pain and suffering, mental anguish and punitive damages.

CONCLUSION

The liability crisis is wide and deep and will worsen unless fundamental changes are made. The few obvious problems that I have identified in my testimony are the result of extensions and accretions of law made case by case without comprehensive and integrated analysis. It is time for our legislative bodies to direct and lead a fundamental reassessment of the basic values and goals of the civil tort system.

Legislative bodies, not the courts, have the power, authority and capacity to end the liability crisis and restore the public's satisfaction and confidence in a fair and just tort system.

I applaud this subcommittee and its chairman for this hearing, and I look forward to the coming of the brighter and better day in our tort system.

Chairman PICKLE. Now we will ask Mr. Victor Schwartz if he will proceed.

STATEMENT OF VICTOR E. SCHWARTZ, ATTORNEY, WASHINGTON, DC

Mr. SCHWARTZ. Thank you, Mr. Chairman. I appreciate your invitation to come here today and talk about the problem that has become the number one economic problem in interstate commerce.

The National Association of Manufacturers, municipalities, and midwives don't agree about too much, but they do agree that this is the No. 1 problem they face, which is the liability insurance availability and affordability crisis.

Let me share with you very briefly my perspective so you know where I am coming from. I have been in this field for 20 years. Most of that time I was in the academic side of the law. I was acting dean of a law school and wrote a book that is used in about 200 law schools today. It is an introductory book in the law of torts.

Then I spent time in the Federal Government. I chaired the Federal Interagency Task Force on Product Liability under both Presidents Ford and Carter.

We examined the product liability crisis that arose in 1976. Our office became, in effect, an office of insurance analysis and we were analyzing problems throughout the insurance area, not just in product liability.

Currently, I am with a full service law firm and handle cases for both plaintiffs and also represent some coalitions that have an interest in legislation pending in the U.S. Congress.

But today I am testifying on my own, not on behalf of any group. This testimony has not been reviewed or seen by any clients.

The past 20 years have seen a real revolution in the law of torts. In 1966, when I began teaching, it was a course that was used to introduce students into the law. It dealt with topics that everybody knew about. The poorest kid, the richest kid in town, could identify with somebody falling down a stairs or getting hit.

Now, it is national news. What happened? Well, tort law was like a 4-inch water pipe that was going along just fine, but suddenly we have thrust thousands of pounds of water in it, and it seems to be bursting all over the place.

You are going to be over saddled with statistics on both sides, some people telling you there hasn't been a rise in cases and other people saying that there has been.

But if you just look to our own Federal courts, in 10 years, between 1974 and 1984, cases rose from 1,500 a year to over 11,000 in 1984. A surge of reported cases in the West Law series dealing with State courts show a 50 percent increase in reported cases over the past 5 years.

Apart from the fact that there is an increase in the number of claims, the cost that attorneys are taking out of the system have increased. Defense costs have increased the most. It is now up to about $0.59 for every dollar going to the victim.

Out of the dollar going to the victim, between 35 and 45 percent goes to an injured person. When one looks at the cause of this—and our panel today is very typical—one is reminded of the old

Thomas Nast cartoon that many of us have seen called Who Stole the People's Money? It showed the old Boss Tweed gang standing in a circle, each one pointing at the other as the cause.

Now, there are only three major players in this circle: the lawyers, the corporations themselves, or people who are engaged in activities that are wrong and/or alleged to be wrong, and the insurers.

The insurance part of the program has interested me, because my old Government office developed the Risk Retention Act. The insurance industry could be found guilty of something over the past few years, and that is underpricing their product. When interest rates were 18 and 19 percent, they could underprice their product, and they did.

If one takes a $1 million premium and the insurers, on the average, hold that premium for about 5 years, and it is invested at 18 or 19 percent until it is paid out, there is quite a bit of money there and enough money to absorb a lot of losses.

When interest rates plummet to 8 or 9 percent, some people say it is going down even more, the insurers have to look at the bottom line and the bottom line is what the potential is for verdicts and rulings of law to be ruled against them in the future.

You don't have to be an economist to understand these figures. They are very dramatic in terms of the difference an insurer can earn in 5 years when interest rates are 8 percent versus 19 percent.

I think the insurers are looking at the future in pricing their product, and I will explain why in a moment and why their guesses may truly be fair.

But we have to assure ourselves of fairness. For that reasons the Risk Retention Act which permits people to group together and self-insure by registering in one State. They then can do business in all other States. The act also permits people to group together and engage in the group purchase of insurance. The act should be extended to lines beyond product liability. It will help assure all of us that rates and premiums are competitive.

On the Senate side where this issue has been debated for some time that Senator Hollings who has very often taken the position of the trial lawyers and Senator Kasten, who has taken the position of corporations on some bills, don't agree on much, but they have both sponsored the Risk Retention Act, S. 2129.

With that in place it will help assure us that the system is, indeed, competitive. But I think there is something you would find, and that is those who self-insure have the same problems that those who are commercially insuring have today.

We see that under the Risk Retention Act where it is operating. In other words, the self-insurers are having to look at the future, what claims are out there, and they, too, are having a problem.

The problem is in arbitrariness of tort law, and until that arbitrariness is surgically removed, we are going to have insurance shortages across the board, both for those who self-insure and those who buy commercial insurance.

Mr. Civiletti touched upon some issues that I think are worth looking into very carefully where arbitrariness occurs.

Let me briefly discuss joint and several liability. That doctrine began in the common law when people acted in what was called a "concert of action" or a conspiracy.

The idea was that each one should be wholly responsible for the wrong, and where it was applied it was fair.

But over time it was extended to all those who could be procedurally joined in an action. The only basis for really bringing those people in was that they were part of the same factual pattern that had occurred, or they had injured a person and the injury was really abysmal, like two cars crashing and a third person being hit.

Courts decided each one of these people who were just joined in an action should be wholly responsible for all the damages, and the courts were reluctant to apportion damages and say, well, A is 14 percent at fault, B is 20 percent at fault, and so on.

In the past 10 years, we have seen the adoption of comparative negligence and courts today do apportion fault. Nevertheless, they have retained this old rule of joint and several liability which can hold a person 14 percent at fault totally and completely responsible.

Now, if you and I were in the insurance business today, believe me, we would have a hard time trying to figure out what the risks were for our own insured, what the risks were for that chemical company, for that medical company, for that midwife, for that municipal liability.

But think what it would be if the law was not only that we would have to worry about our own insured but other people committing acts that our insured didn't commit.

So, you can see very quickly that the rules of joint and several liability can create distortions and arbitrariness in the insurance system.

Mr. Civiletti mentioned the collateral source rule. In its fundamentals, I agree with the collateral source rule. It says that when a plaintiff comes into court he doesn't have to tell the jury or the judge that he has already recovered maybe 80 percent of his costs from other sources.

He had Blue Cross or worker compensation or Social Security. The thesis is that a defendant wrongdoer, an evil person, shouldn't benefit from the fact the plaintiff has obtained money from some other source.

The problem in the law is that this rule has been extended when people have been in accidents and are made to pay under new theories such as risk distribution.

When you have an innocent defendant or a defendant held strictly liable, it is wholly and totally inappropriate to keep from the jury the fact that this plaintiff has already been paid.

It doesn't make any sense at all, and it is extremely costly. Probably the area of greatest controversy, certainly with Mr. Belli, because he helped develop this subject. He was a pioneer in developing damages for pain and suffering.

Way back in the legal history books, damage for pain and suffering was used to rap the knuckles of a defendant. It was akin to what punitive damages are today.

But Mr. Belli and a few others changed the way we think about damages for pain and suffering and made us all think of them as compensatory, as somehow making up for a terrible, horrible injury that occurred to us.

But the damages today are without any limitations at all. The sky is the limit. If it shocks the conscience of the court, then they can be reduced. This uncertainty plagues the insurance market. One doesn't know whether pain and suffering damages will be $5 million, $10 million or nothing.

One can look through jury verdict research and find the exact same situation, a person who became a paraplegic as a result of a car rollover and find a verdict for $100,000, one for $300,000, one for $5 million.

Some reasonable limit should be put on damages for pain and suffering.

There is more uncertainty in the tort law than almost any other area of law. When I am abroad this is the topic that they find hardest to understand. Our tort isn't written down any place other than in opinions of judges.

Now, this committee is familiar with the Tax Code and it is pretty complicated. Can you imagine what it would be if every time a tax issue could come up or came up the Commissioner of Internal Revenue could make up his own rules and forget what he did yesterday, and say, well, I disagree with the last Commissioner, and I am going to make the law this way or that way.

Gentlemen, that is the tort system today. Every time a case comes up totally new rules of law can be made, absolutely, totally.

People have said, OK, Schwartz, hasn't this been going on for 200 years, and why is there a problem now? The answer is, it has been going on for 200 years, but in the past the courts moved real slowly. They moved incrementally. It took the almost 100 years to move from contributory negligence to comparative negligence.

But today they move in quantum leaps. One day a court decides that fault is irrelevant. Another day a court decides that people who misuse products should recover. A third day a court decides that a plaintiff can recover even if he can't identify the defendant. A fifth day a court decides that certain evidence can come in that was never permitted before to try to prove causation.

I can give you dozens of examples, but those are just a few. The changes occur suddenly and the rules are applied retroactively. We must and have to stabilize the system with fair and balanced rules.

Congress can do it in areas that affect interstate commerce, such as product liability, general aviation accidents, and perhaps some others.

Let me finally discuss the legal process and the lawyers. I am one and I represent both plaintiffs and defendants.

The process is costing too much and savings can be had without affecting anybody's rights if we turn our eyes toward reform in this area.

A first area that can be looked at and Senator Mitch McConnell has a bill in on this, S. 2038, is imposing sanctions, stricter sanctions than we have today against people who bring frivolous claims—groundless suits and frivolous defenses, both sides.

Last year, there was a case tried in Michigan where a woman wanted to commit suicide. She locked herself in the trunk of an automobile in her garage. Before she did this, she had turned on the car so that the carbon monoxide in this enclosed area would take her life quietly and peacefully.

But the car stalled and there she was locked in the trunk. Well, she didn't sue the automobile company because the car stalled, but because there was no warning on the outside of the trunk that the trunk could not be opened from the inside.

Gentlemen, that is the tort system today. Now, she eventually lost her case, but it cost the defendant thousands of dollars for a defense that went through the whole parade of witnesses and so on.

Strong sanctions need to be placed in the law against the bringing of frivolous claims and defenses.

The second area of full reform has to do with trying to find ways that will encourage rational settlement early. Senator Danforth is looking at ways and means to do this. Impose sanctions so that if a person fails to settle at net economic loss and then doesn't do much better in the courtroom, he or she has to pay for it.

Likewise, if a manufacturer does not make an offer to settle at net economic loss and then suffers a very large verdict, some sanctions are entered against him.

Let me close with some discussions about the contingent fee.

I am in favor of it. It provides poor people with a lawyer. We re probably one of the only civilized countries in the world that has it, but it does serve its purpose. Yet in many instances for the average lawyer, a lot of the contingency has been taken out of the contingent fee. For example, consider an asbestos client who has asbestosis and has been exposed to a particular defendants' asbestos; you know you have a winner, there is no contingency at all. And yet that fact may not be taken account of in fee schedules.

Some States have sliding scales contingent fee systems; they are worth looking at. As the verdict goes higher and higher, the amount of recovery is less, but a court is given power to review the fee for arbitrariness in case a person has worked hard enough to earn more money than the sliding scale provides. This was first suggested in New Jersey in 1974, the Organized Plaintiffs' Bar said it would add the ability for us to have trial lawyers in New Jersey. A few weeks ago, I was in Newark Airport and tripped. Before I hit the ground, I had cards from two lawyers, so I don't think the sliding scale has ended a person's ability to find a trial lawyer in New Jersey.

Let me mention one thing about the contingency fee that won't reduce cost. Also, it is not going to cure the crisis, but it has to do with basic fairness. When one has a client on the defense side, one has a continuing relationship with that person. The lawyer knows him or her. He wants to deal with the client for a long period of time. We return their phone calls properly. They get an itemized bill showing what we do for every 15 minutes of our time. If there is the remotest question about a bill, we immediately talk to them, and we are talking to somebody who usually has equal or more education than we do.

Now when you switch over to the plaintiff's side, it is very different. Most of the people do not have a lot of education, and all they are told by some attorneys is that their fee will be "35 percent plus costs." Believe it or not, some attorneys in this country do not even tell the client what the costs are. And they are sometimes not told how many hours were put in their case, they are never told that they have an available option for an hourly fee. They are sometimes not told what the probability of outcome is, they are sometimes not told how much money they would make if they are successful. I think this committee and the Congress should encourage bar associations to address those problems.

In conclusion, if you address the insurance part of the problem with the Risk Retention Act and ensure that rates and premiums are competitive and make a few meaningful reforms of the tort system and finally a few, meaningful reforms of the legal process, you can address the insurance crisis for a fair and balanced way.

Thank you for your attention.

[The prepared statement follows:]

STATEMENT OF VICTOR E. SCHWARTZ, ESQ., PARTNER, CROWELL & MORING

Good Morning, Mr. Chairman, and thank you for your kind invitation to testify about the current liability insurance crisis. As municipal governments, major periodicals, and perceptive legislators have recognized, it has become the Number One economic problem that affects interstate commerce today.

Let me share with you briefly my background in the liability area, for my testimony today is not on behalf of any organization or interest group, but solely on the basis of that background. I have been active in the field of tort liability law for exactly 20 years. More than half of that time was spent as a law professor and as acting dean of a law school. I am co-author of "Prosser, Wade, and Schwartz, Cases and Materials on Torts," which is the most widely utilized torts casebook in the United States of America. I have also had the opportunity of writing many articles on almost every major aspect of the subject. For five years, I have viewed this subject from the vantage point of the Federal Government. Under the aegis of the Secretary of Commerce, I chaired the Federal Interagency Task Force on Product Liability and the Federal Interagency Council on Accident Compensation and Insurance. The Task Force studied the product liability problem that arose in 1976, made a report and, ultimately, developed recommendations. One of its principal recommendations became Federal law, the Risk Retention Act of 1981. That act, which I will discuss further, facilitates the ability of manufacturers and product sellers to self-insure. The Federal Interagency Council on Insurance and Accident Compensation coordinated insurance policy among 12 agencies and assisted the Office of Management and Budget in coming to grips with legislative initiatives directed at insurance and accident compensation.

For the past five years, I have switched to becoming "an adjunct professor" and work full time as a partner at the law firm of Crowell & Moring. In that capacity, I co-chair a 14-lawyer group that is active in tort litigation. I want to make clear that we have represented both injured persons and defendants. I also serve as counsel to a variety of groups that have an interest in legislative tort reform.

The past 20 years have witnessed a radical change in the law of torts. When I began teaching in 1966, this area was considered a very "academic one". It was a first year course in law school that had as its main purpose introducing students into the law. It was used because the factual situations were familiar to the wealthy and the poor alike. Why has this "academic" area of law become front page news and created a major crisis for our economy? The best metaphor I can put forward is that of a small water pipe that, for years, handled a flow of water to a community. But suddenly, over the past ten years, courts reached out and began forcing more and more water through the pipe. Today, we have thousands of pounds of water pressure on this narrow pipe—it is no wonder that it has burst and is leaking in many places.

You probably will be over-saddled with statistics, but note that in the Federal courts alone in the area of product liability we have seen a jump from 1,500 cases filed in 1974 to over 10,000 cases filed ten years later. In the past five years, reported product liability cases brought in state courts set forth in the "Westlaw" service has increased over 50 percent.

Apart from the increase in numbers of claims, the cost of litigation appears to be going higher and higher and taking more and more of the victim's award. For example, the Rand Corporation has indicated that in asbestos cases it costs the defense approximately 59 cents in attorney's fees for every dollar that goes to a victim. Of that dollar the victim receives, a plaintiff's attorney takes 41 percent. And one must remember that asbestos cases have become more and more routine in nature. It is crystal clear from all surveys that lawyers are getting far more money than victims in tort cases today. Let me be clear that I am not singling out plaintiffs' attorneys – the cost is on both sides.

When one looks for blame or cause of this crisis, one is reminded of the old Thomas Nast cartoon called, "Who Stole the People's Money?" The cartoon focused on the operation of Boss Tweed's municipal government in the late 1800's. It showed each of the city officials standing in a circle pointing at the other person. In the current arena, we can see the insureds pointing at the plaintiffs' lawyers, the plaintiffs' lawyers pointing at the insurers, the insurers pointing at the other person. In the current arena, we can see the insureds pointing at the plaintiffs' lawyers, the plaintiffs' lawyers pointing at the insurers, the insurers pointing at the courts. Because I represent defendants and also I have sought legislative reform, one might expect my view to say it is all the fault of liberal judges. But one should not be too quick in admonishing our judiciary. Judges look at cases individually, on a case-by-case basis. But they have not, and perhaps cannot, step back as you can in a legislative role and look at the forest instead of the trees. It is my judgment that courts have also been motivated by a concern or an assumption that seriously injured people are going uncompensated. They appreciate the fact that we do not have a full blown national health insurance system, and they have turned to the four inch pipe of tort law as the ultimate means of compensating persons who are injured. This is where the so-called "crazy cases" come from, where people recover who have misused products, where parties who are a small percentage at fault bear total responsibility, where totally innocent defendants are held responsible under newfangled theories, such as "risk distribution". Anyone who has made a serious study of the tort system must recognize that these courts have radically altered the system—tort law was not intended to be a compensation system. The system had its roots in fault—its very name, tort, means "twisted" or "wrong". ——

But the immediate cause of this crisis has been the sudden and broadscale unaffordable or unavailable nature of liability insurance. A recent survey by the United States Chamber of Commerce indicated that 15 percent of its members are unable to obtain liability insurance. Trucking companies, midwives, municipal governments, companies engaged in hazardous waste treatment, hospitals, doctors, and nonprofit organizations, have all experienced difficulties in obtaining adequate liability insurance. In addition, many banks and other corporations are faced with very restricted markets for directors and officers insurance.

Is this the fault of the insurance industry itself? Surely, there have not been such major changes in tort law in the past 18 months to create this crisis out of whole cloth. If the insurers are to be blamed for anything, it is that from 1978 to 1983 they engaged in extreme competition for cash. This extreme competition led to an underpricing of the insurance product.

Let me share with you why this is true. If an insurance company assumes that a claim will not be filed, on the average, until 18 months after an injury, that most injuries will occur on the average of six months after the policy's inception date and that the most serious claims will not be settled until an average of three years after the date they are first reported to the company, then on average, the insurance company will not pay a claim until five years after it has collected the premium.

You do not have to be an economist to realize that varying the amount of the interest rate will dramatically affect the amount of premium that is needed to pay claims that will come due in five years. For example, if a company assumes it must pay five million dollars in claims in five years, and assumes an interest rate of 5 percent compounded monthly, it must obtain a premium of $3,896,026.95. But if it assumes it will earn an average of ten percent on its invested premium dollars, it needs to charge only about $308,942.96 to have five million dollars available in five years.

The bottom line is that high interest rates during the late 1970's masked adverse developments regarding claims frequency and severity.

It should be noted that many persons who criticize the insurers today, would have railed against them if they had not accounted for the fact that they were earning substantial interest on cash reserves.

I believe that it is highly likely today that insurers are acting for the most part with reasonable prudence. But I think we should guard against the possibility that that assumption may not be universally true in all lines of liability insurance and support legislation recently introduced by Senators Kasten and Hollings, normally opponents on liability matters, the Risk Retention Act of 1986, S. 2921. This bill broadens the Product Liability Risk Retention Act of 1981 to cover most lines of liability insurance. It makes it relatively easy for municipalities, midwives, or others to group together to form a self-insurance group—all they have to do is become registered in one state and they can operate in all fifty states.

Also, it permits persons to join together to buy liability insurance on a group basis. It might surprise this Committee to learn that laws or regulations in many states prohibit this practice. I remember when some law students criticized the operation of our law school, I had an associate dean who suggested that we provide them the wherewithal to build their own law school. In essence, this is what the Risk Retention Act does; it makes it easier for people to form their own insurance group. It will help keep the insurance group. It will help keep the insurance market in check without the need for additional regulation.

But I think that the insurance groups may find the same fundamental problem that the commercial carriers face—the arbitrariness and unpredictability of our current system.

Let me cover arbitrariness first with just a few examples.

JOINT AND SEVERAL LIABILITY

At common law, when one or more persons acted in concert or in a conspiracy to do wrong, each could be held responsible for what the other person did. This made sense and was fair. Over time, however, courts created an arbitrary extension of the doctrine that is called "joint and several liability." Here, two or more persons combine to cause an injury that, in effect, is indivisible. For example, it could involve the activities of a manufacturer, distributor and a retailer. Courts permit plaintiffs to recover their entire amount of the harm against any one of those parties even though each one is only partially at fault, even as little as one percent.

This doctrine can be explained in part by history: at common law, courts were reluctant to ever apportion fault. Nevertheless, today courts do it all the time under doctrines of comparative negligence. Unfortunately, these very same courts have clung to joint and several liability. Again, in today's climate it is difficult enough to determine what will happen to your own insured, but this difficulty is compounded an infinite number of times because joint and several liability doctrines can render your insured liable for the wrongful conduct of another person. Joint and several liability should be abolished along the lines set forth in Senator Pressler's recent amendment to S. 1999.

THE COLLATERAL SOURCE RULE

Probably one in ten thousand people knows what "the collateral source" rule is—its name does not belie what it is or does. I think most nonlawyers would be very surprised to learn about it. The collateral source rule says, pure and simple, that a jury and judge must put on blindfolds to the fact that an injured party has already been compensated by another source—a source "collateral" to the defendant. Thus, a person can bring a claim for injuries he received by product where he has already been compensated for eighty percent of those injuries. Most people have already received compensation—the statistical abstract of the United States shows that approxiamtely 40 percent of Americans have some form of health and accident insurance. What we do under the tort system is to double pay and sometimes triple pay for the same injuries.

Perhaps this rule makes sense where the defendant is a wrongdoer—the common law believed that a wrongdoer should not profit from the fact that the plaintiff had been provident and insured himself. But it makes absolutely no sense to impose this rule under modern theories of strict liability where the defendant has not been proven to have engaged in wrongful conduct. And it should never be applied when the plaintiff has been compensated by a source based on tax revenue. This is an area ripe for reform: it can eliminate inefficiency and save costs without reducing necessary compensation.

DAMAGES FOR PAIN AND SUFFERING

Originally, in the history of tort law, damages for pain and suffering or "noneconomic loss" damages were awarded as a sanction against a wrongdoer. It was a strong wristslap applied to a defendant for causing people harm. Today, the wristslap has become a head-on smashing tackle with awards for pain and suffering sometimes totalling in the millions of dollars. The reason for this is that enterprising plaintiffs' lawyers have changed the nature of that doctrine and made it "compensatory." Now we are to compensate for "emotional" harms that people suffer: because it is much harder to get around; because one is ashamed of disfigurement and so on.

Under the tort system where there has been wrongdoing, there is justification for this type of damage award. But in times when economic necessity must govern our actions, it is hard to understand why the sky should be the limit. Moreover, careful studies done by Professor Cornelius Pack of the Washington Law School show that this money does not really make people feel better. It does serve to create very large awards. Some reasonable limit should be placed on damages for pain and suffering when a defendant has been at fault and they are totally inappropriate when a defendant is subject to liability without a showing of his negligence.

THE TORT DAMAGE CALCULUS

As far back as 1917, Professor Terry, a writer in the law of torts, observered that it was necessary "to give" the plaintiff more money than he needed, *i.e.,* utilize the collateral source rule and damages for pain and suffering in order to enable him to pay his lawyer. Under the American system, each of us bears the cost of our own lawyers. But the way the system works, it is an arbitrary calculus, *i.e.,* damages for pain and suffering and the collateral source rule more than make up for the plaintiff paying his lawyer. We would be better off with a system that limits pain and suffering and elimiates the collateral source rule, and simply adds to the verdict an appropriate amount for reasonable attorney fees.

ELIMINATING UNCERTAINTY—STABILIZATION OF BASIC RULES

A tremendous step can be taken in the law of torts if we place some limits on the amount of money that is being expended by the system. But we must also stabilize that system in fundamental areas. Most Americans do not realize that the tort system is still common law, which means in every case totally new retroactive laws can be created and applied. Members of this Committee are familiar with the complexities of the tax code, but imagine how it would be if the rules could be changed in whatever way the Commissioner of Internal Revenue chose every time a new case arose. That is precisely what judges can do and are doing in the law of torts today.

This leads to a key point about our system. Members of the organized plaintiffs' bar will suggest to you that insurers do not have enough data to support increased premiums. But what good is past data if the rules can be altered at will? For example, let us suppose that a new series of judicial opinions holds that airbags must be included in cars, or if they are not, the manufacturer must pay for whatever increased harm the absence of the airbag created. Such a ruling, which is indeed possible, could convert every single automobile accident in the United States of America into a potential product liability case. In that context, how helpful is past claims data in setting rates and premiums?

In 1978 while with the Department of Commerce, I drafted the model Uniform Product Liability Act. At the time I intended to put in a provision which would require that a plaintiff identify who made the product that hurt him. When I made this suggestion, some people ridiculed it as being totally "academic." Nevertheless, two years later the Supreme Court of California held that a plaintiff could win her case even though she did not identify who made the product that injured her. Whether one agrees or disagrees with this case, consider how it affected liability insurance. Again, past data was irrelevant.

The Congress can and should create uniform rules of liability in the product liability area and in other areas where there is a clear and present burden on interstate commerce.

One area where the House can act now is with respect to general aviation. Here, many owners and operators of general aircraft can appreciate that the system has gone too far. The number of planes sold has decreased dramatically from 18,000 only a few years ago to about 2,000 last year. The amount of product liability costs may reach $50,000 or $60,000 per plane. There is no question about the involvement of the Federal Government in the process of aviation and the area is one where if action is not taken, an entire industry will be driven from our shores. A general aviation tort reform bill, H.R.4142, has been introduced by Representative Dan Glickman and several other members of the House. I strongly urge you to support this bill.

In more general terms, the time has come to support fair and balanced uniform product liability law. Efforts to enact such legislation began in the House as far back as 1980 with H.R. 7921. Members should help develop such a bill now.

THE LEGAL PROCESS

Let me finally address waste and unfairness in the legal process. There are four key areas where reform will help.

The first area where reform is needed is with respect to frivolous claims and defenses. Any witness who tells you that plaintiffs' lawyers do not bring frivolous claims and "beat the system" is simply not laying the facts before this committee. We need improvement and more teeth in our sanctions against such frivolous claims and similar sanctions against defense attorneys who unnecessarily delay the resolution of an action. Senator Mitch McConnell, in S. 2038, is looking at this problem with great care.

Second, we need to give serious consideration to settlement forcing mechanisms that will create economic incentives on both sides—plaintiffs and defendants—in order to encourage them to reach an early resolution of the case without the necessity of litigation. The attorney fee structure tends to work against this—defense lawyers are paid by the hour whether such hours are reasonable and necessary to the defense of a claim or not. Senator Danforth and his committee are looking at remedies of this kind.

Third, as a matter of fairness, careful consideration should be given to the operation of the contingency fee in this country. I believe in the contingency fee because it provides the poor person with as good and sometimes a better lawyer than our more wealthier citizens. We are one of the only civilized countries in the world that has the contingency fee, but that does not mean it is bad. The problem is in its opertion. First, today, there is far less contingency in litigation than there was twenty years ago. Many cases are clear liability cases. The lawyer knows from the outset that he has a winner.

Therefore, the old adage that "the losers have to make up for the winners" does not apply. We need legislation that provides sliding scales where the percentage of the lawyer's take is reduced as the award augments. Senator McConnell's bill S.2046, provides an example. This has been done in a number of states and, although the plaintiffs' bar has said such legislation will reduce the availability of lawyers' this has not occurred. In that regard, New Jersey has had such legislation since 1974. Nevertheless, there are plenty of plaintiffs' lawyers in that state. While it may be inappropriate for the Congress of the United States to federalize such areas, it can create incentives for the states to take such action.

Fourth, and in my personal view more importantly, we need to assure that injured people are aware of how the contingency fee system operates and the fact that they might or could select an hourly rate where appropriate. I represent both plaintiffs and defendants. Defendants are savvy with respect to dealing with lawyers. They understand the fee system and know how to bargain. Defense lawyers are eager to please their clients because they want to sustain a long term relationship with them. By way of contrast, the plaintiff's lawyer is dealing with an injured person who often has far less education than his attorney. Nevertheless, the plaintiff's lawyer often supplies less information to his client than a funeral director does to his customer or even a used car salesman. In many instances, the only information the client gets is that it will be "35 percent of the outcome plus costs". Costs are not even defined. This Committee can spotlight this problem and help encourage bar associations to see that adequate and full information is given to clients who are injured.

A combination of enactment of the Risk Retention Act and carefully selected improvements in the tort system will help reduce the wild swings that have occured in our insurance cycle. Selective modifications of the legal process will reduce litigation and help assure that more of the premium dollar goes to injured parties. The current crisis is one that members of Congress can help resolve.

I want to again express my appreciation to members of this Committee who have taken time away from matters that are of primary concern in their jurisdictions to focus on a major threat to our economy. Your interest and co-sponsorship of appropriate legislation can, indeed, allevite what has become a Number One problem for our economy.

Chairman PICKLE. We thank you, Mr. Schwartz, and we thank all of the panelists. You have certainly given us some excellent testimony. I think the most telling point, perhaps Mr. Schwartz, you made it to me, is that product liability insurance is the No. 1 economic problem facing America today in interstate commerce. If we are honest with ourselves, we must say it is a serious problem.

How we address it is within our province, and that is why we are holding these hearings.

Now, let me ask both Mr. Schwartz and Mr. Civiletti. Mr. Belli stated that it is impossible to find out from an insurance company whether they really are losing money or not. Are they making money or are they justified in the increased premiums? Do either of you have difficulty knowing, or have you looked into the issue of whether insurance companies are indeed making money or are not? Can either one of you comment on his accusation that no one can tell whether they are losing or gaining?

Mr. SCHWARTZ. You can look at their annual reports and find out and also the insurance services office, ISO, can provide some data on rates and premiums. But the fact that they are making money and have made profits, and their profits have been relatively low in recent years does not tell about the future. Past data does not necessarily say that in 1988 a court will not come forward with some new major ruling which will double or triple their exposure or a court will not come forward with some ruling interpreting a contract that they have written expanding their exposure.

But I think their profits can be found out from their annual reports.

Mr. CIVILETTI. I think it is true that insurance companies in the casualty business have made money in any number of years over the last 10 years and not much doubt about that. But I think it is also true, and in part a phenomenon of the economic changes, that 1984 was the worst year financially for insurance companies in the last 20 years. The return on net worth was, according to my figures, less than 2 percent and the operating loss was in the neighborhood of $4 billion.

You have to be careful in analyzing the figures because there is a certain amount of accounting discretion which is available to insurance companies between reserve and surplus. But I don't think there is any question the insurance companies are not in the business of losing money or going out of business or cutting lines. They have no incentive to do that unless there are some economic, sound, and basic reasons for that. And the fear is that if the premium structures were not changed, and if in some manner the coverages cannot be estimated, they cannot fairly price the premiums so that there is a fair rate of return to the people who own stock in those companies or own those companies throughout the country, and they cannot really be able to pay the claims which they are insuring over the next 5 or 10 years.

Mr. NADER. I would like to comment.

Chairman PICKLE. I will recognize you, sir. Both of you gentlemen have recommended changes in our tort laws, joint and several liability, collateral source, pain and suffering damages. You are recommending changes that are along the lines of bills that have been introduced by three or four different members and are pending now.

Do either of you recommend Federal jurisdiction over the insurance industry repeal of the McCarran Act? Just give me a general statement, yes or no, because Mr. Nader has recommended that, and I wanted to get your general approach.

Mr. **Civiletti**. I do not have an opinion on the repeal of the McCarran Act, myself.

Chairman **Pickle**. Mr. Schwartz.

Mr. **Schwartz**. In terms of Federal action, there is an area where Mr. Nader and I agree. In fact, some years ago, we worked together to pass the original Risk Reduction Act, which helps assure a competitiveness in these areas. As for the McCarran Act—I don't think there has been a charge the insurance industry has been uncompetitive in recent years. In fact, the charge has been they were overly competitive. Removal of McCarran just assures open and complete competition.

I think you can reach the same result ensuring competitiveness by enactment of risk retention.

Chairman **Pickle**. All right. Now, let me yield to you, Mr. Nader, and/or Mr. Belli, in response to the general statements I raised, or any comments that you want to make.

Mr. **Belli**. I think we ought to have a Federal——

Chairman **Pickle**. The Chair recognized Mr. Nader. I am sorry, Mr. Belli. Afterward I will recognize you.

Mr. **Nader**. Again and again, the insurance industry is asked to put out commercial line by commercial line what they have made in verdicts and settlements. Instead, they give you anecdotes, some of them distorted or false, or give you examples that have been reversed on appeal. The key figure which every legislator must have to make a prudent decision is how much has this industry taken in in premiums and investment income, column 1, how much has it paid out in verdicts and settlements, column two, and subtracting column two from column one, where is the rest of the billion dollars gone, just to find their reserves on a sound actuarial basis, and where are the other expenses in their line of business?

They have not done this. That is why they don't like to quote from the Best Statistical Service, which is the industry's bible, a following excerpt, this is from the major gatherer of insurance statistics, the Best Co.

> In 1984, insurance industry's own estimate of incurred loss and loss expense payments increased by the smallest amount since 1977. And at the same time as the rate of growth of losses was declining, premiums increased by the largest margin since 1976, over 13 percent.

We have to make it very clear, Mr. Chairman, that this industry is trying to generate a revolution in reduction of the rights of injured people, and a deterrence that flows from these cases and the disclosure that flows from these cases, such as Dalcon Shield, asbestos, which helps legislators and regulators, and the expansion of human rights in this area without disclosing the data. They have refused, and the reason is because they can't support their case. Victor Schwartz said if they had to support this data—have to disclose their data, their case would shatter.

The important thing, Mr. Chairman, is this, and this is very critical, and that is that this industry, because of their own financial mismanagement, a quote used frequently in the insurance publications themselves, is not satisfied with increasing liability premiums 25 billion last year, equivalent to $105 per man, woman and child, is not satisfied with doing it again this year, is not satisfied with giving very little attention to reducing their claims by loss prevention. No; they want to reduce the rights of injured people.

And again and again I can show you, Mr. Chairman, that this industry does not experience loss rate; for example, 1 percent of the figures in State after State are responsible for about 25 percent of the payoffs. Why should an obstetrician who has had a good record for 30 years pay as much as an obstetrician who has had 11 valid claims against him? This is an industry that is trying the political power play.

Finally, 156 day care centers in Colorado surveyed, they found that in the last 10 years they have made $1 million in premiums, and $55,000 in claims were paid on their behalf. When the day care center, one of the groups here in Washington, not far away, National Association for the Education of Young Children, they believed the industry line for a number of months, that it was the injuries, it was the courts, even though there is no evidence that these verdicts and settlements in the aggregate have exceeded inflation and population growth.

And then they did their own survey of their members and their following statement, our report shows that, "our nation's child care programs have fallen victim to a fabricated crisis."

Chairman PICKLE. I thank you.

Now, before I yield to other members, I want to give Mr. Belli the opportunity to respond to any of the statements that have been made.

Mr. BELLI. Let me answer you categorically, yes, there should be Federal regulation. There is no industry that is impressed with the public interest more than insurance. I can't stay open. I don't want to retire, I don't want him to stop before he starts, and I have got one at 13, Malia, who is going to be a lawyer, and she can't be a lawyer without insurance. Mom and pop stores can't stay open, day care centers can't stay open, skating rinks can't stay open. They have to have insurance as much as they have got to have their heat, their gas, their electricity and their telephone.

If those are all impressed with the public interest and those are all regulated by the Interstate Commerce Commission, Public Utility Commission, then, by golly, the insurance company, which is just as much impressed has to be regulated by the Federal Government, has to be regulated by the States, or we are just not going to be able to practice.

Then let's take the telephone out, let's take charges for $500 to go between here and New York that we don't have, but railroad commissions and the rest of them, I think that it has gotten to the point, like it was with atomic power and with swine flu—the swine flu program couldn't get off the ground because the insurance companies charged too much for premiums. Atomic power couldn't get off the ground because they charged too much. So the government had to take over.

Now, I think it would be approaching—or would it—socialism if we were to say let the government take over insurance and keep us in business. The architects, the lawyers, the doctors, I think that we are all essential in this great country of ours, I think we all do some good, and I am damn sure that I do some good as a personal lawyer that I bring that Constitution out of that glass cage, and I furl that flag out again, "Don't tread on me," and I want our country to continue that way.

And the only way we can is if we have government insurance, if the insurance companies won't write insurance within reasonable limits, yes, we need Federal regulation, and we need State regulation, but first let's find out what this alleged phony crisis is about, whether there really is one.

Chairman Pickle. Mr. Belli, without going into the area of joint and several liability, on the collateral source rule, I believe you stated that Canada had made some basic tort reforms, yet the premiums in Canada are about as high as they are here. Why is that?

Mr. Belli. This is the source of the problem, the reform of the tort system. I think that it is the insurance companies want to make more and more money, and they are responsible for bad management. Their management has been bad, and the economic times have been bad.

The same way with the farmers, they have had bad times, but they don't want to change the whole system of farming because of that. They have come to Congress for relief and to the President for relief and haven't gotten it, but they aren't responsible maybe for their bad management, but I know that there is, confessed by the insurance companies, bad management. That is part of it.

Chairman Pickle. Thank you very much.

Mr. Schulze.

Mr. Schulze. Thank you, Mr. Chairman.

I would like to thank the panel. It is not only interesting to get their points of view, but it is great theater as well.

Mr. Nader, according to information I have, most of the figures that you asked for are available, and I am sure with the resources available to you that you can get them. In testimony before the Senate Commerce Committee on February 19, 1986, the President of the Reinsurance Association of America stated on page 10 of his testimony that during 1984, reinsurers paid out $133 for every $100 in premiums. Even if you take investment income and everything else, there is no way that you can make money paying out $133 on $100.

Now, I talk about reinsurance because it seems to me this is the second level, where you are spreading the big risks. If the insurers are having problems, then the entire insurance industry will be affected because risk spreading will be limited. In practice, companies will stop writing policies because the reinsurers will not be available to underwrite part of these policies. I think this is happening now.

This leads me to say we must have tort reform. There must be some limitations on damages. These companies, if they are just sitting out there ripping off the public, as Mr. Nader states, I would think Mr. Nader, you would start an insurance company and you would not have to get any donations. You could run your whole establishment on these huge profits that you could make. There is a dire need for people to offer this insurance.

I agree with risk retention, and I think that it must be broadened. But right now even those who we are insuring under the Risk Retention Act are in trouble. So that it is not just the big insurance companies, it is also the little guys. It seems to me that it is everybody.

Mr. Belli, when you say this is the golden age of tort reform, I wonder if you are not referring to the amount of income the trial lawyers are getting?

Mr. BELLI. I had no reference to the goose and the golden egg at all. I was thinking about that last night, maybe I shouldn't learn that because some alert Congressman would pick it up. I shouldn't have used it.

Mr. SCHULZE. It seems to me everybody shares a little bit of blame in this. Let me ask you this, do you think that if we had a specially appointed commission, with all views represented, that we could sit down, out of the public view, and without the emotionalism and perhaps look to the future and say "Here are some areas where we can all get together and try to solve this crisis," or are you all convinced all these evils will stay forever?

Mr. NADER. Congressman, I am convinced if you get a panel together that looks at the data, you will see this is not a victim's claim-driven crisis, this is a cyclical insurance-driven crisis, so they can reassert their level of return, which declined because of their underwriting practices and past financial mismanagement, starting particularly in 1981.

You mentioned the reinsurance figures, you should ask how much of that was put away for future reserves, what was the basis actuarily for those future reserves, and why Lloyds and all the other insurers refuse to answer a simple question, "Will you please disclose commercial line by commercial line, day care centers, office and directors liability, et cetera, your premium income, investment income on the one hand and how much you paid out in verdicts and settlements?"

Unless they actually disclose actual paid losses in dollars, not in disease, not general categories that cannot be examined, unless they disclose them, commercial line by commercial line, they cannot make their case. They cannot even begin to earn your credibility. You would never allow in other areas of legislation any industry to demand such a draconian reduction of personal injury rights with all the consequences of deterrence, disclosure that follow if they did not come and prove their case to your satisfaction.

Mr. SCHULZE. We have seen statistics on the staggering increase of insurance premiums, but are there similar statistics available showing averages for attorneys' fees, settlement agreements, and contingency fee settlements and that kind of thing? What is the average salary of a trial attorney today?

Mr. NADER. That can be gotten—which side, defense or plaintiff?

Mr. SCHULZE. Either way. Probably plaintiff. But both of them.

Mr. NADER. There is quite a disparity. Because the defense lawyer has the meter ticking whether he wins or loses, and the plaintiff's lawyer only gets paid when he or she wins, and not when he or she loses.

Mr. SCHULZE. We have reached the point now where I hear stories about when there is an automobile accident, people are falling over in the street trying to get a piece of the action.

Mr. BELLI. That is not so, though.

Mr. Nader. Nineteen out of 20 victims of malpractice collecting nothing, Congressman. The average salary or earnings of doctors are far in advance of the average earnings of lawyers. The point is this: Let me just cite you some source you may find very credible. The March 10 issue of Business Week has an editorial. This is after they did their major story on liability increases. The title is "Insurers Must Take Part of the Rap." The final sentence, "That is a better way to deal with liability claims than restricting the right of injured people to their day in court."

You and I can agree on how to make the system more efficient, how to cut down the waste, the congestion in the courts, the exorbitant chunk some lawyers take, and the insurance company people tell me they are most concerned with the defense lawyer chunk, which is going very high.

Mr. Schulze. My time is about to expire. I wonder if the rest of the panel would like to comment on whether a specially appointed commission could lead us to a solution?

Mr. Schwartz. Senator Danforth has tried to get together for about 1 year now responsible persons representing all points of view. The consumer groups, AFL-CIO, businesses have sent representatives, the trial lawyers have refused to send anyone to even discuss the matter, because they feel there is no problem, and they repeat a lot of the arguments that Mr. Nader has put forward to try to say there is no problem, or that it is totally the insurance industry's problem. So he has been unable to assemble all the groups involved.

I think what you said about self-insurance is an extremely important point. The fact is many members of a coalition I have worked with—seeking uniform product liability law, which incidentally Business Week endorsed a couple of years ago, so if Business Week is our source for knowledge, we should have had the law enacted a long time ago—are self-insured. I have visited Lloyds. They like other businesses want to make a profit, but they have declined to sell their product and write American product liability law.

Now, I don't know who makes money in business by refusing to enter that business. So we have some groups who are willing to discuss it, but thus far the organized bar has refused to do so.

Mr. Belli. May I just say one word very fast, in behalf of the tort victim movement, and there are many in this country, that I think that our judges are capable of taking care of phonies. At 50 years I don't think I have had one phony. I get 50 calls, 50 calls a day in my office in San Francisco, it is a large office. We take about four or five of them. We don't represent any phonies, and I have never represented any phonies, and for someone to do what you see in the movie pictures or in the old days in the television of going into court and faking a case or standing in the street getting ready to be run down, very, very few of those.

First, they have to get by the plaintiff's lawyer, and that is why a contingency fee is good, because you are not going to put in $50,000 or $100,000 on an alleged quadraplegic if he is something like Lon Chaney in the Miracle Man, that is someone faking that. You don't do it unless you know in your own heart you have got a good case then. Then you have got to get by the judge and appellate court. I think enough of the American public, and if I didn't, I think enough of our good judges, Federal and State, trial nisi prius and appellate, that they ferret these guys out.

I think the guy that comes before the jury ultimately, and I think the jury can see through if a guy is faking. I think there are very, very few fakers that get by in our tort system.

Chairman PICKLE. The time of the gentleman has expired.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Civiletti, Mr. Schwartz, you are both trial lawyers. Would you disagree with what Mr. Belli said?

Mr. SCHWARTZ. I would. I don't disagree that Mr. Belli in his large practice must try to thread out insincere claims. He tries to bring claims he believes to be valid. But there are many other plaintiffs' lawyers who may not. They may bring a claim which they know has very little basis, but after a reasonable period of time make a low-ball offer to settle, which they know comes in lower than it will cost my client to defend his case, so then the client has a Hobson's choice: does he want to pay this rather low amount, which may be $3,000, $4,000, or $1,000, to just get rid of the claim, or does he want to litigate where it may cost him much more?

The clients fall into two categories on this issue. There are those who say $1 million for defense, not 1 cent for tribute; eventually frivolous claims are not brought against those people. There are others who decide it is better off to just pay the people off. That goes on every day in this city, and I am sure in cities throughout the United States.

Mr. NADER. Victor, as an able representative of corporate lobbyists, which you have been engaged in recent years in this tort matter, you must know the same game is played much more frequently on the defense side, where they say "We are going to grind you under with motions and delays, et cetera, unless you give in."

Now, we can work both those sides and have judicial sanctions on both those sides, but the defense bar is very much involved in these tactics as well, and we should not change the fundamental rights of human beings because lawyers are sometimes outrageous. They have to be disciplined in their own right. You don't take away the victim's rights or restrict them.

Mr. SCHWARTZ. I agree that there are both frivolous claims and defenses.

Chairman PICKLE. Gentlemen. I turn the time back to Mr. Anthony.

Mr. ANTHONY. I appreciate Mr. Nader popping in, because I was just getting ready to make the same point. I was a trial lawyer for 10 years before I came up here. I must agree with Mr. Belli to a great extent. The system itself does impose a great deal of discipline on the lawyers. If you are the defense lawyer, and if you know it is a frivolous claim, then you ought to be willing to take that one right on to the court, because, at some point the other attorney is going to hit his choke point. He is not going to find the witnesses to come in, he is not going to find the medical testimony to come in.

I guess what bothers me is that you have made very excellent points in your testimony. When you talk about joint and several liability, I can quote you an antitrust case from my district. A firm was involved for over 7 years in the lawsuit.Their first offer of settlement was more than the entire liquidated net worth of the company.

Well, eventually this company got out, only paid $48,000 basically because of the threat of this joint and several liability and paid over $100,000 in attorneys fees. So I have some sympathy with you when you say maybe we ought to take a look at joint and several liability; but, it does bother me, on the other hand, that we may not be getting anything more for changing it.

Let me report the question I've asked every panel. Let's say you convince the majority of the Members of the House to pass tort reform. Can you tell us what we get in return for it? Will there be additional lines of insurance that will be provided to the public? Will premiums be lowered and will the person who has no claims for a 30-year period of time get insurance. In 1986, he is now being gigged just as hard as the guy who had 100 claims?

Mr. **Belli**. There certainly wasn't in Canada.

Mr. **Anthony**. That is my follow-up question, Mr. Belli. You guys are just too smart.

Mr. **Schwartz**. If you stabilize the system and have rules that give predictability and address some of the vagaries of the law that a lot of people point to as being unfair, and then there isn't adequate response from the insurers, I think you can be virtually certain if you do it in tandem with risk retention, which provides a vehicle, a ready vehicle for self insurance, that people will leave the commercial insurance market and set up their own insurance entities, because they have that predictability.

Mr. **Anthony**. Would you just yield at this point?

Mr. **Schwartz**. Yes.

Mr. **Anthony**. I would like to get into risk retention before you finish answering the question. Just how successful has it been? It is my understanding it has not been that successful.

Mr. **Schwartz**. It has not been that successful because the tort system itself is open ended. If you were to go in the insurance business and insure, for example, medical devices and form a self-insurance entity, you would be facing the exact same problem the commercial insurers face. There wouldn't be any particular rule that you could rely on, you don't know tomorrow whether you are going to be held liable if you are totally and completely innocent. You don't know tomorrow whether you are going to be held completely liable if somebody misuses your product in a totally unforeseeable way. You don't know that.

So how in the world can you go and form a viable self insurance entity? If there were predictability in the system and stability in the system and people agreed on what fair rules were, and I don't think the fair rules should be dictated by business or the trial lawyers, I think that is for Congress to figure out, then self-insurance mechanisms would work.

And my belief as to why they have not been used that much is based on personal experience; I work with these folks, and they face the same open-ended liability scheme as everybody else faces.

Mr. **Nader**. Congressman, of course, you cannot self-insure unless you can be sure of reinsurance. The critical variable here is the behavior of the foreign-based reinsurers led by Lloyds of

London, who set the pace. An insurance company won't insure your apple tree unless they can get reinsurance. So let's focus a little bit on the strategy of the foreign reinsurers whose representatives have been in this country in recent months basically saying they are pulling out of one State after another unless there is tort reform. That is why they are pulling out of the market, not because they are shooting themselves in the foot.

Mr. ANTHONY. The reinsurance people are going to testify later today. A representative of that industry has been in my office to give me a briefing on the industry. He is going to testify that they only reinsured 10 percent of the domestic market to begin with.

Mr. NADER. First of all, Lloyds has at least 15 percent. But it is the pace setter. Other reinsurers will say "Is Lloyds on this line? Oh, good, then we will go on this line." After 330 years, you know, it is the big cheese here. And they are very much in parallel. When you have an industry that is immune from the antitrust laws, they tend to learn how to work together through rating bureaus, through trade associations, through their private meetings.

I just want to emphasize this. The predictability of tort law in Indiana is pretty good. If your infant suffered a wrongful death, you would be lucky to get burial expenses; that is how bad that State is. Yet they are being mistreated and abused, the business community, just like any other State.

The predictability in Canada is pretty good, they started out with the British system, they didn't have tort reform. They started out with these restrictions. And what are the insurance companies and reinsurers doing? Toronto went bare, the inner city bus system in Toronto, 1,000 percent premium increase, day care centers being canceled. You should see the headlines. So there is no guarantee.

Mr. ANTHONY. I think Mr. Civiletti wanted to give a response to a previous question I asked, to repeat if we are asked to pass tort reform, can we be assured we are getting anything in return for it?

Mr. CIVILETTI. Yes; I think you have, No. 1, a fairer system, a less costly system, and a less arbitrary system. I think the kind of discrepancy or inconsistencies Mr. Nader suggests, I think there are a lot of people here who are injured and wronged and under our present system do not recover. I think it would be—I don't think it would hurt the trial lawyers on the defense side or on the plaintiff's side. I think that they would accommodate the system and the reforms, that they would work harder, they could handle cases more efficiently, and I think the competition between domestic carriers, as well as self-insurers—there are lots of companies in between, nonprofit self-insuring groups—who would increase if you had a safe, sound, fair, predictable system.

Mr. BELLI. One fast thing, if I may.

Chairman PICKLE. Well, let me—I will recognize you in a minute, Mr. Belli.

Mr. BELLI. Just very fast.

Chairman PICKLE. Let me yield first to Mr. Guarini. Then I will recognize you, Mr. Belli.

Mr. GUARINI. I will yield to Mr. Belli.

Mr. BELLI. The dog ate my hearing aid, and I haven't been able to get insurance on it to get another one.

California has had a cap on damages in the past 10 years. We get nothing in return. On medical malpractice, there has been a cap on the amount of damages, $250,000 general damages. Instead of premiums going down for doctors, they have gone up, so we got nothing in return there. That was all.

Chairman PICKLE. Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

I want to thank the panel. Certainly there is a diversity of opinion here. In regard to what you just said, Mr. Civiletti, this is our second day of hearings, and we had people before us last week who said they were nonprofit day care centers, and their insurance premiums went up ten times in 1 year, and their loss ratio was nil.

Now, I just don't know if there is good faith on the part of insurance companies or whether this is just plain greed, but I will ask you to comment later.

I try to have an open mind during these hearings, and this being the second day, I find it increasingly more difficult. I do want to commend Mr. Nader and Mr. Belli for their defense of the public and the victims of injuries. I am becoming satisfied that there has been mismanagement on the part of insurance companies. I am satisfied they don't make all their books open so that we could really see how their income has been coming in and how they keep their reserves and how the inside of their operations go, so there is a lot that is arcane, and I got that impression from the GAO that was testifying. I see some members here today from the GAO in this hearing room.

Certainly insurance companies have had every advantage; exemption from the laws, FTC or antitrust, they pay hardly any income tax at all. They have the best shelters in the world, where they can put reserves aside, and they are the hottest issues on Wall Street. There must be a reason why everyone wants to buy into casualty insurance, which is because they know the premiums are there because they are almost out of control, and they can at will, depending on the amount of their greed, charge as much as they want, so many of the premiums in 1 year have gone up four and six and more times, and some of the stories that I hear are rather horrendous.

I hadn't heard, Mr. Schwartz, you make any complaint about the insurance industry. You have made all your statements regarding tort reform and about lawyers, and you are one, but do you put any blame on the fault of the insurance companies, so you can balance out your testimony?

Mr. SCHWARTZ. In my formal testimony, and I was only highlighting parts of it, I do.

Mr. GUARINI. Where are they wrong?

Mr. SCHWARTZ. I think they engaged in overcompetition between 1978 and 1984.

Mr. GUARINI. You mean by overcompetition writing junk and garbage insurance because they wanted to get all the premiums they could because they were getting 18 percent and better return on their investments?

Mr. SCHWARTZ. No, I don't recognize my statements, with due respect, when you repeat them, sir.

They underpriced their products in terms of getting the premium dollar in overcompetition, not writing junk. When two insurers were trying to compete for the business of a pharmaceutical company or a chemical company, and each one offered a better price than the other. And if they hadn't done that, I think a person such as Mr. Nader would be the first one in to say they should be accounting for investment income in setting rates and premiums and should have engaged in more competition.

In fact, organizations that Mr. Nader has been affiliated with have called on insurers to take account of investment income in setting their rates. They did underprice their product. When the interest rates fell, the reality of the bottom line dawned throughout the industry. And they also had to start to look at the future.

Mr. GUARINI. Mr. Schwartz, I think we could have a study made on that, because there has been some disagreement about that one point. I understand the point you are making, and you are making it very, very well.

Let's move on to another subject, because there is some disagreement whether or not GAO can even make a valid judgment based upon the amount of records that were made available to them. You criticized stare decisis or the court system of making judicial judgments. Would you go back to Napoleonic Code as a text book writer on torts? Would that be a better system than the system that we have of the court writing decisions in regard to our tort system?

Mr. SCHWARTZ. No, I would not.

Mr. GUARINI. I can see doing so with the rules of evidence which are procedural, but could substantive law be put down in a code, as you suggest?

Mr. SCHWARTZ. Reasonable rules can be formulated. When the courts are looking at cases, they are looking at them one by one with two people in front of them. The legislature has the benefit of hearing and understanding the whole macroeconomic picture. I think rules can be laid down that are reasonable, can be interpreted reasonably on joint and several liability, on whether liability should be based on fault or not, on whether or not you should look to the fault of a plaintiff or not, as to whether you should be able to introduce evidence of a product improvement or not. There are a few key areas where rules can be laid down that everyone in this room, lawyer and nonlawyer alike, would understand them.

I would suggest that we should be modest regarding how many issues one addresses, no Napoleonic codes, but hit key areas, a number of which were addressed this morning by Mr. Civiletti and myself.

Mr. GUARINI. Are you against the contingency fee which has been known to be the poor man's key to the courtroom?

Mr. SCHWARTZ. Absolutely not. I am in favor of it. Last year, in handling plaintiff's cases, we had substantial recoveries, and I do think it allows a poor person to obtain an attorney. I do believe that in New Jersey and other States that have sliding scale systems that these are helpful.

And, second, I think that something should be done for many clients—not Mr. Belli's, or I think with due respect anybody at this table—who are not informed by plaintiff's lawyers about what alternatives are available to them, about what their rights are, clients often know nothing about how many hours their attorney worked on their behalf.

Mr. GUARINI. I understand you made that point.

Could I ask you lastly, in regard to Europe and other highly civilized nations in the world, is there anything we could learn from some of their systems, and is there any advice that you can give us as to where they may have done some positive reforms and made some headway that we may perhaps learn a lesson from?

Mr. SCHWARTZ. Well, I am suspect of transplants, because foreign systems are based on different cultural roots. For example, Germany does not have contingency fees, but it does supply plaintiffs with lawyers, and I don't know whether we, as a society, are ready to expend the money to supply injured people with lawyers. They do place limits on the length of time that a product or a device can be subject to liability. They have explored no-fault systems more than we have in Australia and in New Zealand, and I think those things are worth looking into.

In a crisis atmosphere, I think we ought to try to come up with some reasonable, not far-reaching changes, and at the same time continue to study alternative system in other countries, such as New Zealand, such as how Europe is now going to be operating under the new EEC Code, which just came into effect 1 year ago. But if we wait to study and study and study, we are going to see small businesses go out of business, midwives not get insurance, municipalities continue with problems.

Chairman PICKLE. Gentlemen, I thank you for your testimony. It has been very helpful, and I think very challenging to us.

Before you gentlemen leave, let me say that it seems to me that we ought to recognize again that we probably have here the No. 1 economic problem facing us in America today, the question of liability insurance. What can we do about it? I think it would be dishonest if we didn't recognize we do have a serious problem here. I appreciate the fact that Mr. Schwartz and Mr. Civiletti would recommend certain tort reforms. Regardless of whether we would endorse all of them, this is an approach of a positive nature to say that in certain areas, we could make some changes.

Now, Mr. Nader or Mr. Belli suggest that the insurance company is, in fact, making profits, at least there is no proper accountability. I think we should ask the insurance industry for that accountability and look into that matter. But in the area of tort reform, as far as the plaintiffs are concerned, it concerns me that I have not heard any recommendations from either Mr. Belli or Mr. Nader with respect to our tort system, or even whether they would support any kind of tort reform at all.

Now, we had a witness Thursday representing consumer groups who said we ought to have some tort reform, such as voluntary arbitration, minitrials, and that this would be helpful.

Mr. Belli, do either you or Mr. Nader recommend any tort reform of any kind, such as voluntary arbitration?

Mr. BELLI. No, but I think eventually the way we are going, and the suggestion is that everybody is going to be taken care of in Social Security eventually, are we going to have a national no-fault, that anyone injured while he has recovered something, he moves from the street into the hospital, and the Federal Government is going to take care of him or the state government is going to take care of him? We are going—the Belli Society is going down to Cuba for a seminar in June, and I am going to ask that question down there in a socialistic and Communist society. Do you bypass the lawyer and does everybody just get taken care of if they are injured, and it is done by administrators? I think we eventually may come to that.

Chairman **Pickle**. I do not know where we will end up, but we do not have a no-fault system that takes care of all these matters.

Mr. **Belli**. Not now.

Chairman **Pickle**. In the absence of that, I am asking specifically, is there any kind of tort reform you recommend we should have? And you said "no." Is that because it would cut into attorneys' fees, the attorneys' business? Did you get my question?

Mr. **Belli**. I didn't, sir.

Chairman **Pickle**. You and I have something in common, Mr. Belli.

You said you do not recommend any tort reform. I am asking you then, is that because that would interfere with the attorneys' business?

Mr. **Belli**. No, just the other day I tried a cancer cigarette case without a fee and paid $150,000 cost myself. I am more concerned with the tort system than I am now with fees.

I think one thing that we might consider, that more arbitration, I think arbitration hasn't been used as much as it should. I think that we have got to have pretrial settlements and get the lawyers together. I think we have got to have these minitrials.

There was one the other day that would have taken 6 months. The judge gave them 2 days, just the lawyers, no parties, and they were able to settle that. There is a lot of little things, a lot of refinements like that that can make it a resplendent tort system, as it is, if you are going to keep the fault system.

Chairman **Pickle**. Mr. Nader.

Mr. **Nader**. Congressman Pickle, I want to emphasize how important it is to draw that line between the rights of injured people under the tort system, which I think are viable, and they should be expanded as the courts have done over the last 100 years. We have gone a long way since the early part of the century when a Mississippi judge looked down on a worker who lost a leg and got a $4,000 verdict and said to him, "I am going to reduce it to $2,000 because your disability is for life, but life only," and draw that line between the rights, like civil rights, civil liberties, and talk about how to improve the system—the congestion, the delay, the secrecy agreements.

I will give you one example of reform. The secrecy agreements between lawyers when they settle a malpractice case and the insurance company says to the plaintiff lawyer, "You want to settle this case? All the information has to be secret, you can't talk about it, you can't give out any information about the incompetent doctor."

As a result, the medical licensing review boards in 50 States, including yours in Texas, do not get this data about incompetent doctors, so they can initiate inquiries and possible disciplinary procedure for license revocation, suspension or probation for prevention, prevention of future malpractice. Now, that is an area.

There are many things we can talk about to improve the system, but I don't want a codified, tax-sensitive, political, manipulated system intruding on the common law of judge, jury and appellate court which has raised the respect for the physical integrity of people in this country to world heights.

Chairman **Pickle**. This committee and any committee of Congress, I know, is trying to recommend a specific answer in the various fields involved in our discussion this morning. Gentlemen, we have a bear by the tail, we are going to have to do something. Now, the Chair must go on Mr. Guarini, do you have a question you want to ask?

Mr. **Guarini**. I want to follow up on something you said, Mr. Chairman.

I think since we do not have any more attorneys who are going to appear before us between now and the end of this hearing, I would like to ask Mr. Belli, if I can, to comment on two or three of the reforms that were suggested by Mr. Civiletti and Mr. Schwartz. I want him to comment on how just a society we are and what his recommendation is for capping pain and suffering. Can you cap pain and suffering where a man is 21 years old, and another man is 65 years old and has a serious injury? How do you feel about a cap, and what would be your position, Mr. Belli?

Mr. **Belli**. I would argue to a jury the last years you have are the sweetest. I think each year probably is worth more than the years, the 20's or the 30's—

Mr. **Guarini**. Would you cap at $250,000? I understand they did in California. Would you put a limit as to how much pain and suffering could be recovered by an individual?

Mr. **Belli**. I would leave it to the wisdom of the jury and judge. If the jury gave too much, the judge could cut it down, the appellate court could cut it down, like that $125 million in the punitive damages, I think it had a good effect with Ford bringing their cars back then, but the appellate court cut it down to $5 million. That was the Supreme Court. I thought the judge should have cut it. I don't know if he should have cut it that much. I wouldn't put a limit because I would leave it to the jury.

In one case, though, we are all free and equal, nevertheless some people are more poignant, more children, more grandchildren, more suffering, depending on education, a lot of health and so forth. When you get up to argue in front of a jury of a 65-year old man and ask how many years has he got, put his life expectancy on the board, it depends on the individual. I don't think I would limit it because there is a lot of things that could be said for an old man that would be unfair if it were a $250,000 limit.

Mr. **Guarini**. Just quickly, I want you to put on the record two points. How do you feel about the collateral source rule? Is it unfair, do you accept the recommendations of Mr. Civiletti and Mr. Schwartz?

Mr. **Belli**. Now, I think the collateral source rule, we had a hard time getting it originally, that it couldn't be mentioned in the main action, and I think that it is fair because it is a different source of payment from a different person, and I don't think he should have a windfall by having someone else having paid it off.

Mr. **Guarini**. Is strict liability wrong?

Mr. Belli. No, I don't think so.

Mr. Guarini. Why?

Mr. Belli. Well, I have 2,000 of those Bhopal cases. I don't represent a client, I represent just the lawyers. When I was over there, they said that their law would be the law of 1856, Reiland and Fletcher, out of the House of Lords, and they had strict liability with water that was breaking forth from some man's land and came over on the next man's land, strict liability, the same strict liability we have now. I think in a case like that, why go into a lot of fact finding demonstrative and everything else when a child can look and see the cause and see what happened, should be strictly liability. I think that is a way to get to the end result fast. I think we should have strict liability in the particular case.

Mr. Guarini. Thank you.

[The following was subsequently received:]

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March 19, 1986

Hon. J. J. Pickle
Cannon House Office Building
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Washington, D.C. 20515

Dear Congressman Pickle:

I would like to commend you and your Subcommittee for the attention given to the liability insurance crisis in recent hearings. I appreciated the opportunity to testify on March 17.

At those hearings, Mr. Belli indicated that there was broad reform of the tort system in Canada, but that it did not solve the insurance cost and availability problems. As a follow-up to this issue, I am sending you a copy of a paper prepared by the Insurance Information Institute. This document shows that Mr. Belli's charge is inaccurate. There was no broad reform of tort law in Canada. Several specific reforms have been made in the Province of Ontario. As the enclosed report indicates, these reforms have been made by judicial decisions and not by legislation. Thus, they are subject to change by judicial decisions and do not create predictability in the tort liability system. This lack of predictability is a major problem in insurance underwriting.

Also enclosed are several other documents prepared by the Insurance Information Institute which respond to charges made by critics of the insurance industry.

Again, I appreciate your efforts at examining the liability insurance crisis.

Yours very truly,

Vic

Victor E. Schwartz

Enclosures

cc: Thomas H. Meyerer (w/enc.)

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February 13, 1986

Nader's Charge on Ontario, Canada Termed Misleading

The Charge: Insurance Woes Unrelated To Tort Law. Leah R. Young. The Journal of Commerce. 86/02/11. Page 14A. Ralph Nader told Washington reporters that the experience in Ontario, Canada, which has many of the tort reform measures being proposed in the United States, "shows that the insurance emperor has no clothes," since, even with tort reform, Ontario is also experiencing high premiums and a shortage of insurance coverage. Jay Angoff, counsel to the Nader-supported National Insurance Consumer Organization, said Ontario already has a cap on compensation for pain and suffering, restrictions on punitive damages, prohibitions on injured parties specifying the amount they are seeking, restrictions on attorneys' contingency fees, few jury trials, and penalties for frivolous suits.

The charge is grossly inaccurate and misleading.

- On a per capita basis, commercial liability insurance premiums are much lower in Canada than in the U.S. In 1985, liability premiums (excluding auto) averaged $18 (C$25) per capita in Canada, compared with $60 per capita in the U.S. The different legal system in Canada is the most likely factor explaining this wide divergence in the cost of insurance.

- There are problems in commercial liability insurance in Canada, but they are not as severe as in the U.S.

- The problems in commercial liability insurance in Ontario, Canada reflect:

    1) the impact of recent statutes, which increase the incentives to litigate;

    2) an erosion of traditional common law disincentives to sue;

    3) the impact of the worldwide contraction in liability insurance capacity.

Richard J. Haayen
Chairman of the Board

Don D. Hutson
Vice Chairman of the Board

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Charles C. Clarke
Executive Vice President

Commercial liability premiums in Canada are expected to show an increase of 15% for 1985, contrasted with a 72% increase in the U.S.

There are, however, some problems of availability of commercial liability insurance in Ontario. This province is known to be litigious. Specific statutory provisions have increased the number and size of claims in Ontario Province:

a) The Family Law Reform Act of Ontario Province (1978). This law extended the number of persons who could sue. For example, under this law a person with only passing acquaintance with another relative (say a grandson) can sue for loss of companionship.

b) The province of Ontario passed a prejudgment interest act, which adds interest to awards from the date of filing.

Also, judicial procedures in Ontario have tended to increase awards beyond expectations. For example, courts in Ontario have tended to add to the award enough money to cover the taxes on interest earned from the award in future years.

In addition, Canada is affected by the worldwide shortage of liability insurance, caused mainly by severe losses by reinsurers in the U.S. market.

The Province of Ontario did not enact a series of tort reforms as might be inferred from the Nader charges. The reforms mentioned are features of the common law system and are not statutory law. Since they are part of common law, they are subject to change by judicial decision and, in fact, there has been erosion in these areas in recent years.

The following reviews the elements of the legal system in Ontario, Canada, that are highlighted in the Nader charge:

1) Cap on compensation for pain and suffering

- In the early 1970s, Canadian courts established through case law a cap of C$100,000 on pain and suffering awards. The cap has since been eroded and the figure now is C$180,000. (Since the cap is set by case law, it can be changed by case law.)

2) Restrictions on punitive damages

These restrictions also are set by case law and have been in place for many years. The restrictions in Canada are in general tougher than those used by U.S. courts.

3) Prohibition on injured parties specifying the amount they are seeking.

This prohibition holds that a jury cannot be directly informed or led by evidence to know the amount of damages sought by a plaintiff. This rule is a common law rule and has been in place for decades.

4) Restriction on attorneys' contingency fees.

In Ontario, attorneys' fees are set by the Law Society. Contingency fees are prohibited.

5) Few jury trials.

Traditionally, Canada has used juries infrequently in civil cases.

6) Penalties for frivolous suits.

Defendants who win suits can collect legal fees and other costs from plaintiffs. This system has been in place for decades.

III
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February 11, 1986

Nader/Hunter Challenge

The Property/Casualty insurance industry shares the concern of state and federal public officials, business and the general public about developments leading to restricted insurance coverages and the rising cost of commercial insurance protection. The insurance industry is deeply disturbed about the actions it has felt compelled to take in certain lines of insurance and for selected types of coverage. The industry welcomes the commitment of the affected policyholders and public policymakers in restoring the legal and regulatory stability needed to provide a responsive insurance market. The industry already has responded with a number of programs in various states aimed at alleviating the distress in various industries.

The industry recognizes that competitive price cutting by the industry in the first half of the 1980's has been a major factor behind the current large increases in rates for commercial liability insurance. The industry beginning about 1979 entered a period of fierce price competition with two major results:

- commercial businesses throughout the U.S. got bargains in the purchase of liability insurance,

- the insurance industry ended up posting record operating losses in 1984 and 1985.

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However, the obvious cyclical factors in the industry tended to obscure a basic phenomenon which had been impacting on the liability insurance system for decades, namely the mushrooming growth in litigation in the U.S., and the associated problem of expanding concepts of liability.

Certain critics of the industry contend that the problems in the availability and affordability of commercial liability insurance are totally due to the competitive nature of the industry and are unrelated to developments in the tort system. The following pages provide brief responses to this and related challenges to the industry.

CHARGE: There is not a tort litigation explosion in this country.

There is a crisis in the civil justice system in America. It is not manufactured by the insurance industry.

- Awards are growing at an alarming rate.

  In 1984, there were 401 awards of a million dollars or more in the U.S., up from 372 in 1983. In 1962, in a less litigious era, there was only one award over a million dollars.

  The average size of verdicts for three common injuries -- cervical strain, knee injuries and vertebrae fractures -- and for wrongful death of adult males, increased at an average rate of 14.3% between 1974 and 1984, more than double the rate of inflation.

- Cases filed have grown at a spectacular rate.

  In federal courts, product liability suits jumped 600% in ten years, from 1,579 in 1974 to 10,745 in 1984.

  In state courts, the growth in filings has been at least four times as fast as the increase in population.

- We produce lawyers in this country at a faster rate than we produce babies. The annual rate of growth in the number of lawyers is six times the growth rate in population. Between 1970 and 1980, the number of lawyers in the U.S. increased 68%, while the overall population increased only 11%.

* In the insurance industry our loss data show what's happening. From 1965 to 1985, losses (dollars to be paid out in claims) in commercial liability insurance increased 2,046%, while inflation was up only 242%.

In 1984, losses in commercial liability insurance increased 25%, and in 1985 losses increased 43%.

* The civil justice system is grossly expensive. For example, in Los Angeles a typical trial costs the taxpayers $11,000.

* The system sometimes delivers meager justice. In asbestos cases, claimants receive only 37 cents of every dollar. The other 63 cents go to pay for litigation costs, according to a recent Rand study.

* The most eminent jurists in the United States believe there's a crisis.

In the words of Chief Justice Burger, the process of going to trial is "not only stressful and frustrating, but expensive and frequently unrewarding for litigants." Other critics of the system include Derek Bok, president of Harvard University and former dean of the Harvard Law School, as well as former Attorneys-General William Smith and Griffin Bell.

Last, but by no means least, is the opinion of the American public. Surveys conducted by the Gallup Organization and Cambridge Reports, Inc. show that the public is fed up with the system.

-- People complain about the excessive delays and outrageous costs of the system.

-- People favor reforms. They favor arbitration as an alternative to going to court.

-- People favor limitations on pain and suffering awards. They favor limits on contingency fees.

Why are people fed up with the system? Because they recognize that what's happening in our society is wrong.

-- In N.J. the Supreme Court ruled that you can't throw a party in your home and serve drinks without running the risk of being sued if someone is injured by an intoxicated guest.

-- Doctors, in addition to taking courses in healing people, are taking courses in how to avoid being sued. According to the AMA, $17.5 billion is spent in this country on defensive medicine - that's for unproductive tests designed to avoid lawsuits.

-- The threat of lawsuits is discouraging the manufacture of vaccines designed to prevent illnesses.

-- Directors of publicly-held companies are resigning because of the rise in lawsuits.

In sum, this is a basic issue of consumer and human rights. The trial lawyers naturally want the insurance industry to be around, because this is the deep pocket that funds them. But who pays for all this?

The answer is well known. Consumers - the general public - pay through higher insurance premiums. In sum, the insurance industry's current high rates are the symptom not the disease.

The pendulum has swung too far to one side -- we have too many lawyers, too many lawsuits and too many changes in legal doctrine.

Specific Nader-Hunter Challenges:

CHARGE:

The insurance industry is exempted from federal anti-trust law. (The implication being that insurance companies act as an OPEC-like monopoly to gouge consumers).

The insurance industry is not exempted from federal antitrust law. The McCarran-Ferguson Act of 1945 provides that regulation of the insurance industry should occur at the state level. However, federal anti-trust laws apply under McCarran-Ferguson if state regulation is deemed to be ineffective and the Sherman Act always applies in cases of boycott, coercion or intimidation. Federal agencies have exercised regulatory powers. The Department of Justice, for example, has successfully challenged acquisitions in the insurance industry which were viewed as discouraging competition. (U.S. vs. Chicago Title and Trust Co., et al., 242F. Supp.56, N.D.,Ill. 1965.)

CHARGE:

The insurance industry reports only underwriting losses. The industry states that in the ten years 1976 to 1985 insurance companies lost $81.3 billion. Insurers neglect to mention their investment income over the same period of $119.8 billion. So overall they made $38.5 billion.

-- The industry reports data including investment income. I.I.I. reports such data to the trade and general public every quarter. Key sources of data, I.I.I. Fact Book, and Best's Aggregates and Averages, prominently display data on investment income.

-- While $38.5 billion sounds like a lot of money, it amounts to an average of $3.85 billion per year. Premiums over this period averaged $96.8 billion so that profit margin on premiums was only about 4% -- 4 cents on the dollar, a profit margin below the rate achieved by most U.S. corporations. For the ten years 1975 through 1984, the rate of return on net worth in the industry averaged 10.9%, 2.3% points below the 13.2% rate of return for U.S. industry.

CHARGE:

The insurance industry pays little in taxes.

Adding up federal, state and local taxes, the industry pays about the same as the average for U.S. manufacturers.

The property/casualty industry pays relatively low federal taxes because much of its income is from tax-exempt state and local bonds.

CHARGE:

The increase in insurance rates is causing an inflationary jolt to the U.S. economy.

The property/casualty insurance industry makes up only 3.6% of the U.S. economy. A 21% increase (as occurred in 1985) in insurance premiums would not even change the inflation rate by a single percentage point.

Insurance rates have been a deflationary force over the past few years. Between 1978 and 1984, the consumer price index increased 59.2%. Premiums increased only 44.6% over the same period.

CHARGE:

The insurance industry won't tell us what we want to know. I have been asking for data, line by line, state by state showing data as follows:

Column 1	Premiums paid
Column 2	Losses paid
Column 3	Investment income

These data are available by line and by state.

Close to 2,000 insurance companies representing over 97% of insurance premiums report data on premiums, losses and expenses, by line, by state, every year.

They report this information in a document called the "Annual Statement", which is over 60 pages long, and contains details on premiums, losses, expenses, investments and taxes.

Insurance companies report on 28 separate lines of insurance. Data on small lines such as day-care centers or professional liability for accountants, are included in aggregates and are not reported separately in the Annual Statement.

Investment income is not reported by line, as a company manages its investment portfolio as a whole. However, allocations can be made to lines of insurance and are reported on this basis in Best's Aggregates and Averages. (See, Best's Aggregates and Averages, 1985, pages 78 and 79).

CHARGE:

The insurance industry reports fictitious losses. They refer to incurred losses but don't tell us about paid losses.

Close to 90% of incurred losses are paid losses. Incurred losses represent losses paid, plus dollars set aside to cover losses to be paid in future years. In many areas of insurance, such as medical malpractice, there is a time difference between when an accident occurs and when a claim is paid. The time difference can be quite long. In liability cases, the process of gathering evidence and court delays can result in a difference of many years between the time an accident occurs and the suit is finally resolved.

CHARGE:

Lloyd's holds the U.S. insurance industry in a vice-like grip. Lloyd's operates without any regulation and is dictating to the United States changes in our civil justice system.

It is estimated that Lloyd's writes only 15% of the reinsurance (insurance for insurance companies) in the U.S., so it can hardly be viewed as controlling the U.S. market. Lloyd's has lost a lot of money in liability insurance in the U.S. Its latest results show that while only 12% of its worldwide premiums were in liability insurance, this line was the source of 100% of its financial losses.

Like any responsible company, Lloyd's began withdrawing from areas where it was losing money, and stated the conditions under which it believes it can write business on a profitable basis.

Lloyd's is an accredited reinsurer throughout the U.S., an eligible excess or surplus line insurer in all jurisdictions as well as a licensed insurer in Illinois, Kentucky and the U.S. Virgin Islands. In addition, a number of federal agencies have also recognized Lloyd's insurance. Each year, Lloyd's files audited financial statements with the U.S. Treasury Department, many State Insurance Departments and the National Association of Insurance Commissioners.

CHARGE:

Insurance companies say they are losing money, yet their stocks were up over 50% last year.

Every analyst of the industry forecast the property/casualty insurance industry would recover. The stock market practically always rises when it is generally believed that a depressed industry is on the road to recovery.

In general, the stock market is a poor indicator of the financial health of an industry. In 1977, the property/casualty stock index fell 4%. The following year, the industry recorded one of its most profitable years in history, with an 18.1% return on net worth.

CHARGE:

What is needed is a federal insurance office to review the industry and to set standards for state regulators.

What is being proposed is some kind of dual regulatory system. These systems don't work very well, as we know from the banking industry.

The banking industry has a dual system of federal and state regulation. Yet, the failure rate of banks is far higher than that of the insurance companies. In addition, despite federal regulation and a federal insurance system, bank failures in recent years have cost taxpayers billions of dollars. One bank, Continental Illinois, received a commitment of $4.5 billion from the federal government to stave off bankruptcy. Failures in the insurance industry do not cost taxpayers, as they are covered by state guaranty funds which are collected from the insurance industry itself.

CHARGE:

What is needed is a federal reinsurance program. Reinsurance is largely concentrated among foreign firms. This would free U.S. business from foreign tyranny just as the goal of energy independence was designed to free U.S. citizens of pressures exerted by oil-producing nations.

A federal reinsurance program could cost the taxpayers of this country billions of dollars. Under a general federal reinsurance program, insurance companies could lay off all their bad risks on the federal government while maintaining only the profitable risks. This also would mean that the losses now being suffered by reinsurers in U.S. markets would be borne by the Federal government, rather than by the private sector.

The foreign tyranny assertion is baseless. About 75% of the reinsurance market is in the U.S. The main advantage of keeping U.S. reinsurance markets open to foreign companies is that the supply is expanded. This means that more insurance capacity is available to

U.S. firms and at a cheaper rate than if reinsurance were restricted to the U.S. companies alone.

Also, pursuing a protectionist policy in insurance markets would have the same negative repercussions of protectionism as in any other industry. Other nations would retaliate, not only against U.S. insurance companies operating abroad, but also against other U.S. exporting industries, such as aircraft manufacturing and agriculture.

In general, the reinsurance industry represents less than 10% of primary premiums. (I.I.I. Reinsurance Monograph, page 60). About 75% of this market is with U.S. companies, and 25% with foreign re-insurers. (I.I.I. Reinsurance Monograph, page 42).

CHARGE:

Thirty-eight states have laws that protect insurance agents by denying groups the right to form their own cooperative insurance coverage.

There are very few restrictions on the formation of groups to purchase insurance or to self-insure. In fact, it is estimated that 25% of commercial lines insurance is in the self-insurance area. Group insurance policies, such as those purchased by employers for their workers or unions for their membership, are allowed in all states. The laws in question deal only with the formation of "fictitious" groups, that is, a group of people, who have no formal relationship with one another. The prohibition on "fictitious" groups is designed to protect consumers who cannot join such "fictitious" groups from paying more for an insurance policy.

CHARGE:

State regulation of insurance is so weak as to be almost non-existent. Only half the states have actuaries on their staff.

The major states have full staffs of qualified actuaries. Small states without actuaries regularly hire actuaries on a contractual basis and consult with experts in other state insurance departments when they have an actuarial problem. In addition, the NAIC publishes actuarial guidelines in its field examiner's handbook and has set up an actuarial task force to deal with problems common to all states. Moreover, insurance companies often are examined by regulators from several states who pool information on companies.

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Nader-Hunter Challenge on 1985

Profit/Loss in P/C Industry

At a press conference in Washington, D.C. on January 6, 1986, Ralph Nader and Robert Hunter, president of the National Insurance Consumer Organization (NICO), asserted that the property/casualty industry had a profit of $6.6 billion in 1985 rather than an operating loss of $5.5 billion, as reported by the Insurance Information Institute.

In interviews with the media on January 6, Dr. Sean Mooney, senior vice president and economist of the I.I.I., and other I.I.I. staff members refuted the Nader-Hunter assertions. By the end of the day, Hunter had lowered his $6.6 billion profit figure to $5.0 billion, as reported by The Wall Street Journal, Jan. 7, 1986, page 12.

At his press conference, Hunter claimed property/casualty insurers would earn $6.6 billion in this way:

	$ BILLIONS
Operating Loss	-$5.5
Capital Gains	+ 6.5
Federal Tax Credits	+ 3.5
Dividends to Policyholders	+ 2.1
PROFIT	$6.6

In refuting the Nader-Hunter claims, Dr. Mooney noted:

1) Hunter accepts I.I.I's report of an operating loss of $5.5 billion based on underwriting and investment performance;

2) Nader's Capital Gains figure includes unrealized gains. This is unacceptable because it violates Generally Accepted Accounting Principles as required by auditors and the Securities and Exchange Commission as well as statutory insurance accounting principles. Unrealized capital gains represent increases in the market value of securities which have not been sold. Therefore, the companies have received no money from them. Hence, they are not included in profit and loss data.

3) Nader's Federal Tax Credits figure is one developed by NICO and grossly excessive. I.I.I. figures on page 3 are based on nine months of actual data reported by insurers.

4) Nader's Dividends to Policyholders entry is wrong. Under general accounting principles, a return to consumers is a price rebate and must be deducted from sales revenues.

The media asked why the industry reported operating figures and not after-tax income at the end of 1985. The I.I.I. year-end press release is based exclusively on data from A.M. Best Company, an independent analytical, rating and information service organization. These data do not include after-tax income.

When the fourth-quarter data are in, the I.I.I. releases the figures, including after-tax income. (See March 20, 1985, Wall Street Journal story, based on March 19, 1985, I.I.I. release. Copies are attached.)

The I.I.I. reports on after-tax profit or loss on a quarterly basis.

The I.I.I.'s estimates for Profit & Loss in 1985 are as follows:

Profit (Loss) in P/C Industry
($ Billions)

	1985	
Underwriting Loss	$(25.2)	Underwriting loss here was supplemented by income from investments (interest and dividends) to produce an operating loss.
Investment Income	19.7	
Net Operating Loss	(5.5)	
Realized Capital Gains*	5.3	However, capital gains primarily from the sale of stocks offset this loss, plus
Tax Credits and Other* Income	1.9	tax credits and other minor income items
		so that
Net After-Tax Income*	1.7	net after-tax income was positive.

*Estimates by Insurance Information Institute.

Why are the I.I.I. figures right and the Nader-Hunter figures wrong? Because with nine months of data available, the net after-tax income was $1.49 billion. It is totally unrealistic to expect a gain in the last quarter more than three times the size of the gain in the prior nine months.

The Institute is hesitant to estimate the after-tax industry result, but based on nine-month data, the figure should be close to $1.7 billion -- far below the Nader-Hunter estimate.

Nader and Hunter question whether there has been a litigation "explosion" in the U.S.

There are many facts to demonstrate the increase in litigation in the U.S. over the last few years as well as the increase in the cost of the tort liability system.

-- Million-dollar verdicts awarded in the United States skyrocketed to 251 in 1982 from one in 1962 and to 360 in 1983, the latest year for which figures are available. The lure of jumbo awards in civil suits often contributes to increased litigation.

-- Civil suits filed in state courts rose 22 percent from 1977 to 1981 and appeals climbed 32 percent. Civil case filings in federal district courts soared to 206,000 in 1982 from a mere 35,000 in 1940. Last year there was one private civil lawsuit filed for every 15 Americans.

-- In the 15 years Chief Justice Burger has been heading the Supreme Court, federal court case filings have risen nearly two and a half times as fast as the population.

-- A 1984 Rand study of thousands of asbestos-related lawsuits showed: Cases closed took an average of two years and eight months, with 11 percent taking six years. How much did victims get? Only 37 cents of each dollar paid. The other 63 cents went for legal fees.

THE WALL STREET JOURNAL
March 20, 1985

Pre-Tax Operating Loss for '84 Is Posted By Property Insurers

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK — The nation's property-casualty insurance industry posted a pre-tax operating loss of $2.9 billion last year, the largest in its history. In 1983, the industry had pre-tax operating profit of $3.04 billion.

After tax credits and capital gains, however, the industry last year posted net income of $1.94 billion, down 68% from $6 billion in 1983.

Such results were expected. Last December, the Insurance Information Institute, a trade group, predicted that the property-casualty industry would post a net loss for 1984. But insurers' tax credits and capital gains both proved to be larger than anticipated, producing net income for the industry rather than a loss, Sean Mooney, the institute's economist, said.

The results released by the institute are based on data from companies representing 97% of the nation's property-casualty premium volume. They were compiled by two other trade groups, the Insurance Services Office and the National Association of Independent Insurers.

Based on the size of the 1984 operating loss, Mr. Mooney said, last year was the property-casualty industry's worst ever. He said the losses surpassed those sustained in 1906, the year of the San Francisco earthquake and fire, which resulted in $375 million damages.

In the fourth quarter, the industry had a pre-tax operating loss of $760 million, compared with pre-tax operating profit of $500 million a year earlier.

After tax credits and capital gains, fourth quarter net income was $848 million, down 40% from $1.4 billion in 1983.

For the full year, insurers had pre-tax losses from insurance underwriting of $20.52 billion, compared with $12.93 billion in 1983. Investment income, primarily interest on bonds and dividends on stocks, was $17.62 billion, up 10% from 1983. Capital gains were $3.17 billion, up 56%.

The industry's poor 1984 performance has been blamed on heavy weather-related claims and lingering effects of a six-year price war in commercial insurance that apparently ended last summer. Still, analysts don't expect earnings to improve until late this year or early 1986.

iii Insurance
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Release Date:
Immediate

for INSURANCE SERVICES OFFICE, INC.
and the NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

ISO, NAII REPORT YEAR-END 1984 PROPERTY/CASUALTY INDUSTRY OPERATING RESULTS

NEW YORK, March 19 -- The nation's property and casualty insurance industry reported net after-tax income of $1.94 billion in 1984, down 68 percent from the 1983 net income of $6.0 billion.

The industry recorded a pretax operating loss of $2.9 billion in 1984, compared with pretax operating income in 1983 of $3.04 billion. The 1984 operating loss consists of a pretax underwriting loss of $20.52 billion and pretax net investment income of $17.62 billion.

The industry's pretax underwriting loss of $20.52 billion for 1984 was $7.59 billion greater than the loss of $12.93 billion in 1983. The underwriting loss includes $2.10 billion of premiums returned to policyholders as dividends in 1984, compared with $2.16 billion a year ago.

(more)

The $17.62 billion of net investment income for 1984 (primarily dividends earned from stocks and interest earned on bonds), was up 10.3 percent from a year ago. Net investment income, combined with realized capital gains, which rose 56.1 percent to $3.17 billion, brings the industry's total pretax net investment gain for 1984 to $20.79 billion, up 15.4 percent from $18.01 billion a year ago.

The figures were released by Insurance Services Office, Inc. (ISO) and the National Association of Independent Insurers (NAII), reporting for insurers that account for 97 percent of the country's property/casualty insurance business.

The 1984 underwriting loss of $20.52 billion was 18.2 percent of the earned premiums of $112.49 billion. This compares with the 12.4 percent underwriting loss on earned premiums of $103.89 billion for the year 1983.

Written premiums for 1984 totaled $115.87 billion, up 9.4 percent from $105.87 billion in 1983. That growth compares with the 4.6 percent growth of 1983 over 1982 written premiums.

— For the fourth quarter of 1984, the industry's net after-tax income was $848 million, compared with $1.40 billion for the fourth quarter of 1983, a decrease of 39 percent.

(more)

The industry recorded a fourth-quarter 1984 pretax underwriting loss of $5.85 billion, compared with the $4.03 billion loss a year ago. The fourth-quarter 1984 underwriting loss included $582 million of premiums returned to policyholders as dividends, compared with $793 million in the fourth quarter of 1983.

The industry's pretax net investment gain in the fourth quarter of 1984 was $6.20 billion, up 24.5 percent from $4.98 billion in the fourth quarter of 1983.

The fourth-quarter 1984 loss of $5.85 billion was 19.6 percent of the period's earned premiums of $29.91 billion. This compares with the 14.9 percent underwriting loss on earned premiums of $27.11 billion recorded for the fourth quarter of 1983.

Written premiums in the fourth quarter of 1984 totaled $29.45 billion, up 14.1 percent from $25.80 billion in the fourth quarter of 1983. That growth compares with the 6.7 percent growth of 1983 over fourth-quarter 1982 written premiums.

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March 19, 1985

SOURCES OF DATA ON FINANCIAL RESULTS (Property/Casualty Insurance)

1. Most data published by the Insurance Information Institute are from A.M. Best Company, an independent analytical, rating and information service organization.

2. The A.M. Best Company data are collected from individual insurance companies throughout the United States. Each insurance company is required to report to each state in which it is licensed what is known as the convention statement. A.M. Best Company receives copies of these reports and adds the data up line by line, company by company, to produce a total. This total is then increased by a small factor (less than 3 percent) to produce an overall industry aggregate figure. The incremental factor is used mainly to reflect estimates for companies not required to report to the state insurance departments. In many states, small farm mutual companies are not required to report.

3. The Institute publishes data from a quarterly report issued jointly by Insurance Services Office, Inc. (ISO) and the National Association of Independent Insurers (NAII). These data are collected each quarter from companies representing about 97 percent of premium volume in the U.S. The data are received by ISO and NAII in the form of answers to questions, e.g., what were your written premiums in the past quarter?

CONCEPTS OF PROFIT/LOSS IN THE PROPERTY/CASUALTY INSURANCE INDUSTRY

There are several ways of measuring profit and loss in the property/casualty insurance industry, as there are in any other industry. The different concepts used depend on the question being asked and the perspective of the inquirer. For example, a regulator frequently will have a different perspective on data than a shareholder of an insurance company. Some of the common measures of profitability are:

1. Net profit/loss after taxes.

This is the basic concept of bottom-line earnings. This number is the bottom line on the income statement of most U.S. companies. The figure includes losses or gains from underwriting, investment income (interest income and dividends), realized capital gains and federal income taxes. Shareholders are interested in this figure because it provides some indication of whether dividends will be paid and at what rate. However, this figure does include extraordinary items and other factors, which may be of a transitory nature. Of key importance for property/casualty insurance in recent years has been the impact on this figure of federal taxes and realized capital gains.

In the case of federal taxes, what was normally a subtraction from before-tax income has turned into an addition. This is because companies were losing money before taxes and received a credit for taxes paid in the prior three years -- a form of income-averaging for companies. Realized capital gains also increased in importance in the past few years, partly because of the strong stock market, but also because of the need by insurance companies to raise cash to pay losses. In calculating bottom-line profit or loss, the profit or loss from the sale of stock is included regardless of the purpose of the sale.

2. Operating profit/loss.

Because this figure includes the key operating concepts -- underwriting profit or loss and investment income, it is the most reliable indicator of how the property/casualty industry is doing. It excludes realized capital gains or losses and federal taxes.

3. Underwriting profit/loss.

The underwriting profit or loss is calculated by subtracting incurred losses (funds assigned to pay claims) and expenses (e.g., commission to insurance agents) from earned premiums. It does not include income from investments. This figure tells a regulator how a company is doing in the basic functions or the business -- selling insurance and paying claims.

4. The combined ratio.

The combined ratio is similar to the underwriting profit or loss. The combined ratio is the sum of the ratio of incurred losses to premiums earned and the ratio of commissions and expenses to premiums written. A combined ratio above 100 means that the industry is incurring more in claims and expenses than it is taking in in premiums.

Chairman PICKLE. I thank you, gentlemen. We would like to go on and on, because I think we would all profit from it. But, in courtesy to the other panels we have scheduled, we must go on to the next panel. I thank you all very much for your testimony.

The Chair would ask John Crosby, Dale Skupa, David Farmer, and Michael Thompson if they would come and take their place at the witness table.

Mr. ANTHONY [presiding]. John Crosby, vice president and general counsel, National Association of Independent Insurers. Welcome, Mr. Crosby. We know you are no stranger to this room having worked here for many years. Welcome back.

Dale Skupa, vice president for government relations, National Association of Mutual Insurance Cos.; David Farmer, vice president, Federal affairs, Alliance of American Insurance Cos.; and it is a special pleasure to welcome Michael Thompson, executive committee member, Independent Insurance Agents of America.

We will take your testimony in the order which you have been introduced.

STATEMENT OF JOHN B. CROSBY, VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. CROSBY. Thank you, Mr. Chairman. It is a pleasure to be back before the Oversight Subcommittee, having worked for a former member of this subcommittee. I feel it is a privilege to be back before you on this critical issue, and I commend the subcommittee for bringing this important topic to the public fore.

I would like to respond initially to a couple of the statements made by the previous panel, just to clarify a couple things in this high theater, if I may. First of all, Mr. Nader stated that the insurance industry is exempt from the antitrust laws, exempt from FTC investigations and somewhat exempt from the Federal Tax Code. None of those statements is correct.

We are subject to the Federal antitrust laws, those relating to boycott, coercion, potential conspiracy. We are investigated by the Federal Trade Commission, and, in fact, last year two studies were released by the FTC in automobile and personal lines insurance, and they found the insurance industry to be highly competitive. And as you well know, in the tax discussions of last fall before this committee, the insurance industry proposed a $5.5 billion package of reforms and revenue-raising measures which ultimately found their way into H.R. 3838.

I would respond to Mr. Belli's statement that we are in the golden age of tort litigation by stating that if things aren't changed very quickly, the golden egg may soon vanish. When you have 40 major insurance companies going insolvent or going bankrupt in the last 2 years and over 215 insurance companies on the watch list by their respective State insurance commissioners, it is hard to see that this is the golden age, at least in the insurance industry.

Mr. Chairman, my statement is replete with statistics on the state of the industry, which you can refer to at your leisure. I would just point out a few things. Over the period of 1979 to 1984, we did engage in cash flow underwriting in the insurance industry.

We do take part of the rap for what has ultimately evolved. Written premiums in that period went up only 34 percent. They should have gone up much more in order to pay for the potential losses. During that same 5-year period, interest rates went down and our investment income went down.

Over that same period of time, GNP raised 50 percent. In that same 5-year period, 1979 to 1984, we have incurred severe losses, up 76 percent on an industry basis. If you look at commercial lines alone, losses increased 92 percent. For commercial liability, losses increased 130 percent and in the medical malpractice liability area, losses increased 167 percent.

Why did these losses occur? We have had a breakdown in our civil litigation system, as Mr. Schwartz and Mr. Civiletti explained, through judicial misinterpretation of contracts, expanding liability concepts and the magnitude of our potential liability. Everybody in the insurance industry and many of our insurance consumers are convinced that the civil litigation system has broken down. How else can you explain the combined ratios of 118 percent for all lines of insurance? That means for every dollar we took in in premiums, we paid out 118 cents.

In medical malpractice, as I stated, we are paying out $1.68 for every dollar we take in in premiums. In governmental liability insurance, the figures are even worse. We pay out $2 in losses, verdicts, settlements for every dollar we take in. Every witness will advocate some reform of the civil litigation system in order to bring back fairness and equity to the system, not to take away rights of plaintiffs or rights of plaintiffs' attorneys to bring cases on behalf of them, just to restore some balance and fairness to the system so that we can operate as we have in the past.

Now, you have heard a lot of claims for Federal regulation of the insurance industry. Implicit in this argument is that somehow State regulation has broken down. How could 51 insurance commissioners who highly regulate our industry all be asleep at the switch at the same time? An analogy to that would be to say that 435 Members of Congress were asleep at the switch as the budget deficit increased over the past several years. This is a societal problem, not just a problem in terms of State regulation or the insurance industry alone.

Every time in the past 10 years that the Federal Government has tried to take over one form of insurance regulation or another, be it riot, crime insurance, flood insurance, or swine flu, there have been failures. In the swine flu case alone, we are still experiencing today, after 10 years, $85 million in insolvency in that program and a fourth of the claims are still pending in the courts.

When will this ever end? I ask you, can we afford another Federal solution given this past track record?

The availability crisis in insurance, particularly commercial liability, is easing as Commissioner Lyndon Olson of Texas testified before you last Thursday. Surplus lines markets are coming around in problem areas, like governmental liability, day care liability and liquor liability, just to name a few. Thirty-four States have established market assistance programs where consumers who are having problems getting insurance can turn for assistance, advice and ultimately relief.

Finally, I would say that the National Association of Insurance Commissioners has taken the lead in identifying many of these problem areas in an attempt to resolve the availability crisis without further governmental intervention.

I would like to close with one last point, Mr. Chairman. If the industry has any cloud over its head, it is a charge that Ralph Nader and Bob Hunter and other so-called consumer advocates brought last fall, alleging a conspiracy on the part of the insurance industry to manufacture a crisis in order to do something in the tort area. These are very serious charges, and they impugn the credibility of thousands of insurance executives and insurance companies that are trying to do business and make a fair and reasonable profit in this country.

I would ask Mr. Nader and Mr. Hunter and your subcommittee to look into this with your oversight responsibilities. Where is the evidence of this conspiracy? If they have the evidence, why don't they produce it for the Justice Department and Attorney General Meese? If they are withholding evidence, they are guilty of a major crime themselves. If they don't have the evidence, they are misleading the public.

It is time for Mr. Nader and Mr. Hunter to put up or shut up, or, as Walter Mondale said last year, "Where is the beef?"

Thank you.

[The prepared statement follows:]

Statement of John B. Crosby, Vice President and General Counsel, National Association of Independent Insurers

The National Association of Independent Insurers is a voluntary national property and casualty insurance trade association of more than 500 member companies. Our members range from the small one-state writers to the very largest national writers. They are stock, mutual and reciprocal companies and they have a mix of merchandising the insurance product from agency to direct writer and direct mail.

WHAT AVAILS US IN THE AVAILABILITY CRISIS

I have just heard from Soviet astronomers tracking Halley's comet that the comet will veer sharply this summer and collide with the earth. It looks as if our planet is doomed. Later this week, Ralph Nader and Robert Hunter will hold a press conference and blame insurance ratemaking procedures.

The insurance industry is often accused of reacting to events when it should be initiating them.

The availability crisis is a notable and welcome exception to that criticism. The industry has set the agenda for this problem in the states. In jurisdiction after jurisdiction, legislators, regulators, business groups and media surveys name the availability crisis as Issue Number One.

Some of the attention arises from negative factors that have caught everyone's interest—higher prices, non-renewals and mid-term cancellations. Nevertheless, on the positive side, insurers are receiving a largely sympathetic hearing for their views on the underlying cause of the trouble—abuse of the civil justice system. Reform is being discussed in terms of our recommendations.

But we are paying the price of being out in front. Offering recommendations in papers, testimony and speeches is a bit like Stendahl's definition of novel-writing—volunteering to be shot in public. What Stendahl didn't mention was where you might get hit.

The potshots at us are coming from several directions.

The most notorious is the charge by Mr. Nader and Mr. Hunter, and the contingent fee lawyers, that insurance companies manufactured the crisis. Some people in the industry think they're shooting from the lip for publicity purposes, but I'm not so sure. I take them at their word. I don't believe they would be so rash as to make empty rhetoric with so serious an accusation.

They are accusing dozens or hundreds of insurance executives of a conspiracy to defraud the public. The federal antitrust laws, to which we are subject, explicitly prohibit that. The penalties are stiff—a jail term and triple damages if you're found guilty.

Mr. Nader and Mr. Hunter have been repeating these charges for several months. We've waited patiently for them to produce their evidence. Now the time has come for them to put up or shut up. If they have any proof of a conspiracy—meetings, phone calls, anything—they should present it at once to the Justice Department and Attorney General Meese. If they don't, then they're withholding evidence of a crime. If they don't because there is no evidence, then they've been misleading the public. By all means, let's hear what the Justice Department has to say about these accusations.

Frankly, it's hard to follow the thinking of these two men. They've been saying recently that if insurers are in dire straits, it's because they under-priced their product in the early '80s and they have no one to blame but themselves for not raising prices then.

It's curious that Mr. Nader and Mr. Hunter failed to warn anyone at the time that insurance was under-priced. On the contrary, in October of 1980, they said automobile insurers had over-priced their coverage by a cool $4 billion by failing to include investment income in their ratemaking. They demanded price cuts. And in April of 1981, *they* were calling for a boycott of Aetna because the company had raised its prices.

Mr. Nader and Mr. Hunter, and their allies in disinformation, the contingent fee lawyers, also make the astounding assertion that the industry is doing well financially.

To make this preposterous claim, they're forced to ignore what is common knowledge. 1984 and '85 were the two worst years in the history of property-casualty insurance. The 1984 underwriting loss was $21 billion, nearly five times the previous record. When the year-end data are available for last year, the underwriting loss will top $25 billion. For the first two years in history, investment income could not cover our losses.

The industry's return on net worth in '84 was a meager 1.7 per cent. It's expected to be only four per cent in '85. That compares with a 13.6 per cent average for Fortune 500 companies. And the only reason we made it into the black at all was tax credits and unusually large realized capital gains.

All this counts for nothing with the critics, however. The industry only looks that bad on paper, they say, because the industry distorts its data or does not produce any data at all.

We may be witnessing medical history here. This must be the first known instance of accounting by Freudian projection, because our critics are guilty of the very thing they accuse us of.

Their use of data might well be called the "if" school of accounting. If you pay no attention to these devastating losses . . . if you move policyholder dividends from the loss column and treat them as profits . . . if you remove all catastrophe losses . . . if you include unrealized capital gains . . . if in short, you stand accepted accounting practices on their head, then presto! the crisis vanishes.

Of course, reality and good sense disappear with it too.

Actually, the industry includes realized capital gains in its income and always has. Unrealized capital gains flow directly into surplus and don't become income until they're sold. No accountant worth his calculator would treat them as income.

Catastrophe losses were unusually heavy in 1985, over two per cent of premium. In the last ten years, they've averaged 1.3 per cent. But under what delusion would anyone remove ALL of them from the industry's books?

Under the rules of the NAIC and the Financial Accounting Standards Board, policyholder dividends are not included as income. They are deductible as a legitimate business expense because they are not profits. They are essentially the same kind of discount or rebate to consumers given by manufacturers of appliances or cars.

Try as they might to divert attention from them, the industry's critics can't get around the $46 billion in underwriting losses we have sustained in the last two years. They have tried to suggest that the industry mis-states its future losses by over-reserving. But the facts show that the opposite has occurred.

In 1976, during the last tight market, our reserves were $47 billion. By 1984, we had paid almost $49 billion on those claims and still had $8 billion to be paid, for a total of $57 billion. So we were not over-reserved, but nearly 20 per cent under-reserved, due to the impossibility of predicting future liability, particularly in commercial lines.

Recently, another angle has been used to try to downplay the industry's undeniable losses. Two weeks ago, the New York Times ran an editorial acknowledging that some tort reform was needed, but blaming the insurance underwriting cycle as the main culprit.

This availability crisis is not the result of a normal cycle. What we are experiencing is longer, deeper and more widespread than any previous cycle. We tumbled around in the trough of this so-called cycle for six years—twice the length of a normal cycle. Until 1984, the record underwriting loss was $4.2 billion in 1975. Last year, it hit $25 billion. The last cycle bottomed out in 1975 at a combined ratio of 108. In 1984, the ratio soared to 118. Not only primary insurers, but reinsurers have been savaged as never before in history. We set a new record for insolvencies in '84 and '85—nearly 50 companies bankrupted and 400 more on the NAIC's watch list.

Between 1979 and 1984, the Gross National Product went up 50 per cent. Our premium volume rose only 34 per cent. But our losses skyrocketed 76 per cent. Last year alone, they increased 15 per cent over the year before. In two of the most troubled lines, general liability and medical malpractice, losses are up 167 per cent since 1979.

These crushing losses, and their non-cyclical character, are the best link we have at present to the solution we're advocating—tort reform.

So far, the industry's position has been extensively and, on the whole, fairly treated. But it's getting harder, not easier, to set the record straight after the Naders and Hunters have confused it, while at the same time, push forward our recommendations. We haven't yet made a conclusive case that these atypical losses are not merely a by-product of cash-flow underwriting, but actually reflect deep flaws in the civil justice system.

Our problem lies in the fact that our data gathering procedures were designed to help us run our business, not to prove or disprove anything about the legal system. Nevertheless, that is the task expected of us now and we must accept the challenge.

Today, in state capitals and Washington, when we're asked to demonstrate the effects of legal flaws on insurance, we have to rely on the logic and common sense that Justice Potter Stewart used when he was asked to define pornography. He admitted it was difficult to come up with an exact definition, but added: "I know it when I see it."

We know what these unrelenting losses mean. We can see in individual companies the sharp increases in loss adjustment expenses. In some jurisdictions, we can measure the effects of the litigation explosion. But at this stage, we are still working with bits and pieces of the picture.

I have no doubt that we'll get through this crisis, but we should be concerned about its ultimate cost and side effects. Availability is what the army would call the forward edge of the battle area, and it can expand rapidly. How we marshal our facts, how we handle this crisis, will have an impact far beyond the availability problem.

A bill is pending in Washington today that would increase the industry's taxes by $5 billion in spite of the disastrous experience of 1984 and '85, and despite the clear danger of widespread insolvency.

The federal branch is carrying a deficit of nearly $180 billion, plus the added pressure of Gramm-Rudman-Hollings, but the availability crisis has already prompted re-examination of the McCarran-Ferguson Act and the usual cries for federal regulation. It makes no difference that the availability crisis would have occurred irrespective of federal regulation, or that federal regulation of insurance programs in the fields of flood, crime, riot reinsurance and swine flu have feen failures.

We have to respond to these threats as part of our work on availability by showing legislators and the public that we appreciate wider interests than our own, and we accept our fair share of responsibility for the crisis. Our answer, a combination strategy of tort reform and changes in industry practices can succeed in making an availability crisis of this severity the last one we'll ever see. Thank you.

Mr. ANTHONY. Mr. Skupa.

STATEMENT OF DALE D. SKUPA, VICE PRESIDENT OF GOVERNMENT RELATIONS, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. SKUPA. Good morning. My name is Dale Skupa, vice president of the National Association of Mutual Insurance Companies, and it is a national trade association comprised primarily of mutual insurance companies varying in size, from the largest national property and casualty company to very small companies, which provide only fire coverages in a single township.

Many of our companies specialize in certain types of coverages and are designated as farm, county or township mutuals. They were organized during the late 1800's to address a market void and meet the insurance needs of rual America.

Before we address the specific issues of the liability insurance crisis, perhaps we should review exactly what insurance is. Insurance can best be defined as a divice whereby a number of persons, each of whom is subject to the same risk or chance of loss, contributes to a common fund to compensate the few who actually suffer a loss. This is based on the law of large nunbers, which, simply put, means that events occur with predictable regularity, and the more times the event happens, the more closely the result will approach the predicted outcome.

There are several principles in addition to the law of large numbers upon which insurance operates. One of the most basic of these is the principle of insurability. Generally, only those losses which are accidental as to the insured which occur without deliberate intent are insurable.

Another fundamental of insurance is the principle of indemnity. The purpose of insurance is to reimburse the insured financially for an accidental loss sustained. It is not intended that an insured profit from a loss. The objective is to restore the individual financially to the position enjoyed prior to the loss. This is the principle of indemnity.

Similar to the principle of indemnity is the concept of insurable interest. This may be defined as an interest of such a nature that an occurrence of the event insured against would cause a financial loss to the insured. A person must have an insurable interest if payment is to be made under an insurance policy.

On the basis of these principles, we can develop a good idea of what insurance is. What it is not, is a form of gambling, as has at times been suggested. In gambling, the act itself creates a risk where none existed before. Insurance provides protection from risks that already exist. It aims to satisfy the basic human desire for security.

The overall operating loss in the property and casualty insurance industry for 1984 was $4.1 billion. Year end 1985 results will show no significant improvement, despite substantial premium increases.

Insurance companies do operate in a highly competitive market, however, and they must respond to the actions of other insurers if they intend to stay in business. Many insurers did cut prices lower than they should have during the recent price war, with the result that even prudent insurers now find themselves in the position of having to raise prices and seek new sources of capital to provide coverage in today's market. Other insurers that were not as successful are now in financial difficulty, force either to cut back on the risks they can assume or increase premiums substantially in order to continue writing insurance.

While current availability and affordability problems are certainly due in part to past price reductions, a major contributor to the problems has been the significant increase in losses. Policyholders had the benefit of low insurance price levels from 1979 to 1984, price levels that did not keep pace with losses. As a result, the insurance industry experienced below average returns on net worth.

The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses nor make up for recent substandard returns.

Most of the 1985 premium increase has taken place in commercial lines, which grew by $17.8 billion, or 30 percent, as the industry reacted to the growth in losses for these lines. These increases in commercial insurance loss costs are a matter of concern, since they are outpacing the costs of other goods and services.

The property and casualty insurance industry, through its recent business practices, must accept some responsibility for the current liability insurance crisis. At least equally at fault, however, is a civil justice system that has gotten out of control, creating an inability to develop sound pricing schedules or to reasonably predict loss.

The insurance industry, especially those who write liability coverages, have watched the tort system slowly erode. Many of the more common liability defenses based upon traditional fault concepts—joint and several liability, governmental immunity, and contributory negligence—have been struck down in recent years. The proper goal of our civil justice system is to ensure that injured parties are compensated fairly for actual damages. Unfortunately, the courtroom is being used more and more as the forum for deciding who, if anyone, will pay.

As civil suits have grown more complex, determining precise fault has become much more difficult. The courts have adjusted legal doctrine so that fault plays a much less important role today than it did previously in establishing responsibility for wrongdoing.

The tendency is to place emphasis on providing injured people with some form of compensation, regardless of blame. Ability to pay often becomes more crucial than who is at fault, and the burden of paying usually falls on those with deep pockets.

The insurance industry did attempt to call attention to these issues and asked for help in righting many decisions being made to the detriment of consumers. Very little support was provided. In fact, only the usual rhetoric as heard from those groups that traditionally charge the insurance industry with crying wolf for its own benefit.

The property and casualty insurance industry has been accused of manufacturing the current liability insurance crisis in order to force changes in our civil liability system that would ultimately lessen their responsibility to pay legitimate claims. This is not an attempt to curtail the civil rights of individual citizens.

The tort system does not protect those rights as it currently operates, but, rather, puts them in danger through unpredictability and inconsistency. The American civil justice system, with all its faults, is the fairest of any in the world, but it has developed problem which must be addressed.

In suggesting these changes to the tort system, I am not ignoring the fact that the property and casualty insurance industry must also put its own house in order. It is readily apparent that we have a major rebuilding job to do, both in the underwriting and pricing of commercial insurance products. Insurance companies must return to sound underwriting practices.

Those same companies must also establish and maintain adequate loss reserves and surplus. And it will be very important that the entire insurance system be thoroughly examined so that changes can be brought about that will produce reasonable results. After all, the system must be one that the public will support and can pay for.

Many suggestions have been made as to how the current problems in liability insurance should be solved, including proposals to change the McCarran-Ferguson antitrust exemption, expand the Risk Retention Act, establish more stringent guidelines for the insurance industry and establish Federal reinsurance programs. Quick, impulsive changes may create a temporary feeling of relief; however, until the real cause is dealt with and not just the symptoms, very little of subbtance will be accomplished.

During the 1950's and 1960's, several specialty substandard autowriters became insolvent, leaving many policyholders without protection. The 50 States subsequently adopted the guaranty fund system now in operation. These funds were intended to protect personal lines, policyholders, and claimants against loss of unearned premium and claims payments due from the insolvent carrier.

Today, the majority of guaranty fund losses—and they are sizable—are developing primarily from commercial carriers. Guaranty funds were never intended to cover those.

A review of the guaranty funds is currently underway. Overall, our insurance system has provided reasonably good service in the past. Our business community has prospered. The personal lines consumer can afford reasonable coverage to protect their investments. These lines should not be tampered with. Those markets that have deteriorated so badly thay they cannot be priced, however, may need to look to the various States for assistance.

The companies of the National Association of Mutual Insurance Companies, many of whom have been in existence for more than 100 years, are working, individually and together, through their national association, to solve the problems confronting today's insurance industry and to meet the needs of the insuring public. We all have one common goal and are willing to work with anyone who is interested in reasonable solutions that will benefit everyone.

I thank you, again, for the opportunity to appear before you today and to offer NAMIC's position on this very important question.

[The prepared statement follows:]

STATEMENT OF DALE D. SKUPA, VICE PRESIDENT, GOVERNMENT RELATIONS, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES [NAMIC]

Good morning, Mr. Chairman, and members of the subcommittee. My name is Dale Skupa. I am the Vice President of Government Affairs for the National Association of Mutual Insurance Companies (NAMIC), an insurance company trade association of property and casualty insurers. I appreciate the opportunity to appear before you today on behalf of our more than 1,275 member companies to discuss the current crisis in availability and affordability of liability insurance coverages.

The majority of NAMIC members are mutual insurance companies, varying in size from the largest national property and casualty companies to very small companies which provide only fire coverages in a single township. Many NAMIC companies specialize in certain types of coverages and are designated as farm, county or township mutuals. They were organized during the late 1800's to address a market void and meet the insurance needs of rural America.

Among the remaining membership, many of the companies are large and write property and liability coverages of all types. These companies range in size from the very largest to moderate sized insurers.

The Association, which was founded in 1895, is headquartered in Indianapolis, Indiana. Its president is Harold W. Walters. Washington counsel is Davil A. Hartquist of Collier, Shannon, Rill & Scott, 1055 Thomas Jefferson Street, N.W., Washington, D.C.

PRINCIPLES OF INSURANCE

Before we address the specific issues of the liability insurance crisis, perhaps we should review exactly what insurance is.

Insurance can best be defined as a device whereby a number of persons, each of whom is subject to the same risk or chance of loss, contributes to a common fund to compensate the few who actually suffer a loss. This is based on the "law of large numbers," which, simply put, means that events occur with predictable regularity, and the more times an event happens, the more closely the result will approach the predicted outcome.

There are several principles, in addition to the "law of large numbers," upon which insurance operates. One of the most basic of these is the principle of insurability.

Generally, only those losses which are accidental as to the insured, i.e. occur without deliberate intent, are insurable. They are not insurable if caused intentionally by the individual suffering the loss. Nor is a loss considered insurable if it was in imminent danger of taking place. For example, insurance would not be issued to cover a building if the adjoining building were in flames.

Another fundamental of insurance is the principle of indemnity. The purpose of insurance is to reimburse the insured financially for an accidental loss sustained. It is not intended that an insured profit from a loss. The objective is to restore the individual financially to the position enjoyed prior to the loss. This is the principle of indemnity.

Similar to the principle of indemnity is the concept of insurable interest. This may be defined as an interest of such a nature that an occurence of the event insured against would cause a financial loss to the insured. A person must have an insurable interest if payment is to be made under an insurance policy. As with the principle of indemnity, the principle of insurable interest follows the idea that insurance is to alleviate or eliminate a financial loss which would result to the insured from the occurence specified in the policy.

On the basis of these principles, we can develop a good idea of what insurance is. What it is not, is a form of gambling, as has at times been suggested. In gambling, the act itself creates a risk where none existed before. Insurance provides protection from risks that already exist. It aims to satisfy the basic human desire for security.

The primary property and casualty insurance business is generally separated into two categories: commercial lines and personal lines. Many companies write both commercial and personal line coverages, while many others write predominantly one or the other. Further, many of these companies will oftentimes write only certain classes of business within either the commercial or personal lines area. Commercial companies may limit their business to long-haul trucking operations, professional liability, liquor liability, or farm coverages. Personal line companies may write only private passenger automobile insurance, homeowners insurance or motorcycle coverages.

Reinsurers also often provide capital and share the exposure at risk with these primary writers.

The majority of NAMIC member companies write personal line coverages, which affect almost all consumers. As the various cycles have developed over the last 20 years, the commercial lines remained relatively profitable while the personal lines often experienced problems of affordability and avilability. As a result, may of these regional and small companies began to spread their exposures beyond the personal lines area and attempted to acquire a share of the commerical insurance market.

Today, we see the situation reversed. The problems in property/casualty insurance have not yet directly affected individuals. House, car and personal liability policies are still generally available, while commercial insurance coverages have become almost impossible to obtain or are obtainable only at a dramatically increased rate.

LIABILITY INSURANCE AVAILABILITY AND AFFORDABILITY

Insurance operates on the principle of risk sharing. Each member of a large group, or classification, of policyholders is exposed to the same kind of possible loss. Each member contributes a certain but lesser amount—the premium—than might be lost if an unforeseen mishap occurs. The insurer pays the much larger actual claims for those accidents that some of the group will have from the total amount accumulated. When the total number of amount of the whole group's claims increases unexpectedly, as has been this industry' experience over the last few years, claims dollars paid out can quickly exceed premiums collected by a substantial amount.

The overall operating loss in the property and casualty insurance industry for 1984 was $4.1 billion. Year end 1985 result will show no significant improvement, despite substantial premium increases.

There are a variety of reasons for this deteriorating loss experience, not the least of which is how the property and casualty industry has operated in the last decade.

As you know, a period of intense competition existed in the property and casualty insurance industry during the late 1970's and early 1980's, both in types of coverages offered and in premiums charged. For almost 10 years, insurance buyers benefited as insurance companies introduced new products and coverages, and provided more coverage at lower prices. Most insurance companies handled themselves responsibly during this period, offering greatly increased coverage at lower prices while still keeping a realistic eye on their obligations and the bottom line.

Insurance companies do operate in a highly competitive market, however, and they must respond to the actions of other insurers if they intend to stay in business. Many insurers did cut prices lower than they should have during the recent "price war," with the result that even prudent insurers now find themselves in the position of having to raise prices and seek new sources of capital to provide coverage in today's market. Other insurers that were not as successful are now in financial difficulty, forced either to cut back on the risks they can assume or increase premiums substantially in order to continue writing insurance.

While current availability and affordability problems are certainly due in part to past price reductions, a major contributor to the problems has been the significant increase in losses. Policyholders had the benefit of low insurance price levels from 1979 to 1984, price levels that did not keep pace with losses. As a result, the insurance industry experienced below average returns on net worth.

The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses nor make up for recent substandard returns. Such increases are needed simply to bring insurance prices in line with the costs of policies written today.

Although large increases in property and casualty insurance have been experienced recently, they are not as extensive as has been alleged. Critics have charged that property and casualty insurance premiums rose by almost $25 billion in 1985, from $117.7 to $142.3 billion, while coverage decreased substantially. This supposedly works out to an increase of $105 per person for substantially less coverage.

These figures are misleading. The $25 billion increase is for all property and casualty premiums, not just for one segment of that industry.

Personal lines premiums, for the coverages purchased by individuals to protect their autos and homes, increased approximately 12 percent, or $7 billion, in 1985. That's an increase of $28 per person, not $105. The increase in personal line premiums in 1985 approximated the 13 percent increase in personal lines losses. It has been estimated that personal lines paid losses and loss adjustment expenses increased $5.5 billion in 1985 equivalent to an average $23 payment per person. After all losses and expenses, insurer underwriting loss for personal lines was over $1 billion more in 1985 than in 1984.

There do not appear to be significant marketplace problems in the personal lines. Large premium increases are the exception rather than the rule, and restrictions in coverage have been rare.

Most of the 1985 premium increase has taken place in commercial lines, which grew by $17.8 billion or 30 percent, as the industry reacted to the growth in losses for these lines. These increases in commercial insurance loss costs are a matter of concern, since they are outpacing the costs of other goods and services.

The property and casualty insurance industry, through its recent business practices, must accept some responsibility for the current liability insurance crisis. At least equally at fault, however, is a civil justice system that has gotten out of control, creating an inability to develop sound pricing schedules or to reasonably predict loss.

The insurance industry, especially those who write liability coverages, have watched the tort system slowly erode. Many of the more common liability defenses based upon traditional "fault" concepts—"joint and several" liability, governmental immunity, and contributory negligence—have been struck down in recent years. The proper goal of our civil justice system is to ensure that injured parties are compensated fairly for actual damages. Unfortunately, the courtroom is being used more and more as the forum for deciding who, if anyone, will pay.

As civil suits have grown more complex, determining precise fault has become much more difficult. The courts have adjusted legal doctrine so that fault plays a much less important role today than it did previously in establishing responsibility for wrongdoing.

Today, the tendency is to place emphasis on providing injured people with some form of compensation, regardless of blame. Ability to pay often becomes more crucial than who is at fault, and the burden of paying usually falls on those with "deep pockets."

The court system in many states and cities is experiencing significant congestion, with time before trial usually stretching for several years. Awards in excess of $1 million are becoming more and more common. Awards for pain and suffering, and other subjective damages, often bear no relation to the degree of injury actually suffered.

Punitive damage awards have also become common, despite the fact that they do not compensate a plaintiff for injury and are often windfalls.

We have also seen that awards for the same injury or loss are inconsistent—judgments against doctors, municipalities and corporations, for example, run much higher than judgments against individual defendants with lesser resources.

Nor do plaintiffs always receive their fair share of the money awarded from their judgments. A recent study has shown that approximately two thirds of an average judgment in asbestos litigation goes for the cost of litigation and for attorney's fees.

The courts have also expanded their definitions of enforceable rights, thus creating new areas of liability.

The insurance industry did attempt to call attention to these issues and asked for help in righting many decisions being made to the detriment of consumers. Very little support was provided. In fact, only the usual rhetoric was heard from those groups that traditionally charge the insurance industry with crying "wolf" for its own benefit.

Some business leaders, along with the insurance industry, foresaw the severe consequences of a tort system out of control and had the wisdom to establish the Institute for Civil Justice within the Rand Corporation. This organization performs independent, objective policy analysis and research on the American civil justice system. These empirical studies reflect many of the concerns that have been voiced in the past regarding the tort system and the apparent lack of concern for consumers.

Broad based tort reform should be enacted by the various states to stabilize the civil justice system and make its costs manageable for society. This can be accomplished in a number of ways:

1. Requiring mandatory and binding arbitration for small claims.
2. Relating attorney contingent fees to the amount of awards, on a graduated basis—note that this is not a call for elimination of attorney contingent fees but of a reasonable limitation.
3. Eliminating or limited punitive damage awards.
4. Allowing juries to consider other sources of reimbursement to avoid duplicate compensation to the plaintiff.
5. Barring the submission to juries of specific dollar amounts being sought in law suits.
6. Establishing reasonable limitations on "pain and suffering" awards.
7. Apportioning liability through a modified comparative negligence system to consider the extent a plaintiff is responsible for any injuries or damage, and, further, prohibiting recovery if a plaintiff's negligence is found to be greater than the defendants.

Replacing "joint and several liability" with "several liability" is another major reform that should be considered. Joint and several liability permits a plaintiff to recover the whole award from any single defendant, regardless of whether that defendant was one percent or 100 percent responsible for the damages. Under this line of reasoning, the defendant bears the burden of allocating costs among other negligent parties. This only breeds more litigation and often results in the award being borne largely by the defendant with the most resources but not necessarily the greatest negligence.

The property and casualty insurance industry has been accused of manufacturing the current liability insurance crisis in order to force changes in our civil liability system that would ultimately lessen their responsibility to pay legitimate claims. Nothing could be further from the truth. This is not an attempt to curtail the civil rights of individual citizens. The tort system does not protect those rights as it currently operates, but, rather, puts them in danger through unpredictability and inconsistency. The American civil justice system, with all its faults, is the fairest of any in the world, but it has developed problems which must be addressed.

In suggesting these changes to the tort system, I am not ignoring the fact that the property and casualty insurance industry must also put its own house in order. It is readily apparent that we have a major rebuilding job to do, both in the underwriting and pricing of insurance products. Insurance companies must return to sound underwriting practices. Those same companies must also establish and maintain adequate loss reserves and surplus. And it will be very important that the entire insurance system be throughly examined so that changes can be brought about that will produce reasonable results. After all, the system must be one that the public will support and can pay for.

There has been a strong, competitive market for professional and commercial insurance coverages. Now we are seeing those classes of business disappear from the primary insurance market, relying instead on self insurance, pools, and captive insurance companies. It is very likely that these markets will never find their way back to the private primary insurance industry.

Allegations that the property and casualty insurance industry has eliminated profitable lines are ridiculous. What would be the point? Once that line is discontinued there certainly can be no profit to the insurance carrier. And, after all, isn't profit the reason we are in this business to begin with?

Many suggestions have been made as to how the current problems is liability insurance should be solved, including proposals to change the McCarran-Ferguson antitrust exemption, expand the Risk Retention Act, establish more stringent guidelines for the insurance industry and establish federal reinsurance programs. Quick, impulsive changes may create a temporary feeling of relief; however, until the real cause is dealt with and not just the symptoms, very little of substance will be accomplished.

We can look to insurance organizations developed to handle the difficult areas we are discussing as an example, and the results are anything but satisfying. We are seeing problems with carriers who specialize in medical malpractice coverage, companies managed by long haul truckers, and companies managed by the energy industry. Even the Federal Crop Insurance Corporation results are such that, under the same conditions, no private company could survive.

A better solution would be a combination of stronger state regulation and greater discipline on the part of the property and casualty insurance industry. As a major part of that, we recommend a thorough review of the current guaranty fund structure.

During the 1950's and '60's several specialty substandard autowriters became insolvent, leaving many policy holders without protection. The 50 states subsequently adopted the guaranty fund system now in operation. These funds were intended to protect personal lines, policy holders and claimants against loss of unearned premium and claimed payments due from the insolvent carrier.

Today, the majority of guaranty fund losses—and they are sizable—are developing primarily from commercial carriers. Guaranty funds were never intended to cover those.

Overall, our insurance system has provided reasonably good service in the past. Our business community has prospered. The personal lines consumer can afford reasonable coverage to protect their investments. These lines should not be tampered with. Those markets that have deteriorated so badly that they cannot be priced, however, may need to look to the various states for assistance.

Another problem area is reinsurance. Regional and small primary writers are extremely dependent upon reinsurance to provide them with capacity and a reasonable spread of exposure. Unfortunately, reinsurance industry results are disasterous! Consequently, lines that are difficult to price or determine anticipated results are being ignored. As a result, NAMIC members are also frustrated in their attempts to provide reasonable services to their agents and their community.

As I said earlier, individual personal lines have not been affected in the current crisis. But individuals will clearly bear the cost. Consumers will pay higher fees for health care, education and entertainment, higher state and local taxes, and higher prices for just about everything. Society will bear the cost in the form of the countless products and activities that are no longer available because they can't be insured. And society will suffer through the chilling of the entrepreneurial spirit that must result if insurance is unavailable for new products or services.

The companies of the National Association of Mutual Insurance Companies, many of whom have been in existence for more than 100 years, are working, individually and together, through their national association, to solve the problems confronting today's insurance industry and to meet the needs of the insuring public. We all have one common goal and are willing to work with anyone who is interested in reasonable solutions that will benefit everyone.

I thank you, again, for the opportunity to appear before you today and to offer NAMIC's position on this very important question.

Mr. **Anthony**. Thank you, Mr. Skupa.

Mr. Farmer, you are recognized.

STATEMENT OF DAVID M. FARMER, VICE PRESIDENT FOR FEDERAL AFFAIRS, ALLIANCE OF AMERICAN INSURERS

Mr. **Farmer**. My name is David M. Farmer, and I am vice president for Federal Affairs for the Alliance of American Insurers, a national association of over 175 property and casualty companies. We are very pleased that this subcommittee has chosen to look at and to discover the problems that exist in the area of liability insurance. But, before I begin, it might be helpful to say that companies in the Alliance, and other companies represented here, we are talking about liability insurance.

These are the same companies that sell property insurance. These are the same companies that sell personal lines insurance and health insurance. So, we are not talking about the entire spectrum of products that the insurance industry sells. We are talking about liability insurance.

During recent months, and in the last year and a half, there has been expressed an increasing amount of concern at the State and Federal level about the problems of securing liability insurance for businesses and professions. Let me say from the outset of my testimony that our member companies and the industry itself did not make these decisions lightly, nor without an awareness of what the consequences of those business decisions were.

However, those decisions were necessary for long-term economic survival. No company or companies voluntarily want to incur the wrath of Ralph Nader, Joan Claybrook, large and small businesses, and your constituents.

The first panel talked about pain and suffering. There is a lot of pain and suffering going on in many executives of the insurance industry as they are called to task on the State and Federal level to answer for the actions that have taken place so no one would voluntarily go through this kind of exercise. I think that there is a misunderstanding of what facts do exist.

What are the facts? The year 1984 was the worst year in the history of the property and casualty insurance industry, a return on net worth of less than 2 percent.

We talk about whether or not the companies are charging more than they need to cover the risk. In the last 24 months, a record number of companies have become insolvent. We have had a downgrading from A.M. Best & Co., a company that grades insurers on their financial rating. They have been wholesale downgrading 220 companies which are on a watchlist by the State regulators on their financial condition.

To suggest that this is somehow a phony crisis manufactured solely to blackmail the American people into changing the tort liability system is absolutely absurd. The records of every insurance company are on file with the State insurance regulators. The annual statements due March 1 are available and in your States and every other State in the Union. The precise information relating to the financial condition of individual insurers is available.

We are going to hear later on from regulators. It is important that this committee and other committees listen to the people who, day in and day out, regulate this industry.

Is the insurance industry to blame for the current crisis? Clearly, the industry engaged in vigorous price competition; but, after all, that is the free enterprise system.

Companies competing against one another for business, whether it is airlines or whether it is trucking or any business—we want, as a matter of national policy, to have companies vigorously compete.

Obviously, there was so much competition that 40 of them are here today to be able to answer some of your questions, simply because they charge too little.

Is there a problem in the civil justice system in this country? The civil justice system in this country is out of control.

A doctor today will tell you they are afraid to practice medicine. Why? Because their patient may sue them.

The cost of medical malpractice insurance—and most medical malpractice is not written by commercial insurers but written by physician-owned and -operated companies—they formed their own companies to write malpractice, and they can't charge enough to cover the ever-increasing liabilities.

The civil justice system, 22 percent increase since 1974 in product liability cases filed.

People want facts: 1,600 product liability cases in 1974; 13,500 in 1985.

People want facts: 24 verdicts over $1 million in 1974; over 400 million-dollar verdicts in 1984.

What can the Congress do? What can the States do? I think, very clearly, the charge that we want to take away victims' rights is also absurd. We want to restore some balance in the scale of justice.

We don't want to abolish the contingency fee system. We are simply suggesting that lawyers receive a quantum amount for the work performed; that a fee so far out of excess of the work performed is something we, as a Nation, cannot afford to pay. There needs to be some regulation, not elimination.

In terms of joint and several liability, it is absurd that a municipality that is 3 percent at fault ought to be able to pay 100 percent of the judgment. That is absurd. We need a system that allocates responsibility on a comparative basis.

We look forward to working with this committee and other committees of the Congress in addressing these problems. It is our business to provide insurance for the public. We want to provide insurance. We want to work with policymakers to eventually figure out what we all want, and that is available and affordable liability insurance.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF DAVID M. FARMER, ALLIANCE OF AMERICAN INSURERS

Mr. Chairman, my name is David M. Farmer and I am Vice President, Federal Affairs, for the Alliance of American Insurers. The Alliance is a voluntary membership organization composed of over 175 property and casualty insurers. Our members provide property and casualty insurance to millions of homes and businesses throughout the United States. We are pleased that the Subcommittee on Oversight has chosen to examine the current situation as respects liability insurance and appreciate the opportunity to express our views.

During recent months, there has been expressed an increasing concern from some quarters about the problems of securing liability insurance for some businesses and professions; for others, concerns about cost have been expressed. From the outset, let me say that we share the concerns of the affected industries. Actions taken by individual insurers that have an adverse impact on our customers are not ones that are taken lightly or without an awareness of the consequences. We believe, however, that business judgement necessitated the actions that have occurred.

We need to examine two areas as they relate to insurers—legal and financial to adequately understand what is happening to property and casualty companies.

The legal climate is not a static environment, it is a changing one. One which society, through legislative and judicial bodies, determines the rights and remedies of parties to a dispute. Over the past ten years, some significant changes have occurred. In state courts, the latest studies show an increase in litigated cases of 22-percent from 1977-1981. In 1962, only one civil award amounted to $1 million. In 1982, there were 251 awards of $1 million or more.

The problems of a runaway civil justice system are by no means confined to private defendants "for the twelve month period ending March 1984."

U.S. Deputy Attorney General, Carol Dinkins, reported that nearly 11,100 cases involving the U.S. Government were filed in the Federal District Court.

The civil justice system in this country needs change—not tomorrow, but today. Left unchecked, this system will engulf our ability to compensate victims of injuries. Already, the insurance industry has lost the ability in certain lines to adequately price the cost of coverage. Two particular examples of this are pollution liability and liability for asbestos removal operators.

Liability insurance is a vital part of our modern economy and because of governmental mandate, a necessity for some businesses.

One example illustrates this situation. Recently, the EPA had to decide whether or not to suspend the requirement for mandatory liability for the operators of hazardous waste sites. In a recent hearing before the House Energy Subcommittee, an EPA official stated the reasons the coverage requirement was not suspended was due to the fact that without insurance "adequate protection may not be provided to human health and the environment."

While we certainly understand the reasons for that position, it is stated by state and federal regulators for a variety of coverages. I would like to remind the Subcommittee that the casualty insurance industry despite significant resources has a finite supply of capital—as of this moment, probably around $70 billion. The Office of Technology Assessment recently estimated that the cleanup of hazardous waste sites would cost $100 billion.

On one hand, it is reasonable to require protection for operators of hazardous waste sites. However, these requirements are sometimes made without a clear understanding of all the facts. One can mandate coverage but if the insurance industry does not have the capacity or if the underlying legal system is out of balance, there are bound to be significant problems.

An industry observer at a symposium on hazardous waste held on November 18, 1985, stated the problem rather succinctly, "environment impairment liability insurance created in 1982, by 1984 has one or two markets. The finger of blame must be pointed not at the judiciary but at legislative and regulatory arms of government. On the other hand, responsibility for the effects of overreaching construction of the pollution exclusion must be placed entirely on the shoulders of the judiciary." (William Mahoney, Marsh and McClennan. *Second Annual Hazardous Waste Symposium,* November 18, 1985). We agree with that assessment.

On the financial side, the industry is experiencing a continuing slide in earnings.

In this difficult environment, insurers face problems where they must allocate available capital. In lines of business where there is complete uncertainty about the present and future, companies are no longer providing coverage. A number of casualty insurers are in a difficult financial position and some carriers have gone out of business.

We have seen problems in a variety of liability coverages, although I would add that the problems are not occurring in every state or jurisdiction. They vary by state and by line of coverage.

In the following pages of my testimony, I will attempt to describe some of the problem areas of liability coverage and some possible solutions.

MUNICIPAL LIABILITY

The municipal liability problem can be traced to the erosion of a well-settled principle of law that governmental entities could not be sued without their consent. That is, the federal and state governments and municipal corporations which have power to legislate, as well as counties, townships, and unincorporated divisions of a state, traditionally were not liable for damages for their neglect of public duty.

Since the mid-1970s, state legislatures and the judiciary have significantly eroded the doctrine of sovereign immunity, particularly in regard to municipalities. In some cases, amendments to state constitutions or changes in state law, totally or partially abolished sovereign immunity as applied to local units of government, particularly as to municipalities. In addition, the courts generally hold that where the legislature by statute abrogates the immunity of the state from liability, such laws also repeal the immunity of municipal corporations, counties, towns and all other political subdivisions of the state.

Not only have the courts eroded the doctrine of sovereign immunity, they also found other avenues to create liability where none previously existed. The courts have held municipalities liable for violation of the constitutional rights of citizens and have also required municipalities and other local government entities to indemnify claims against municipal employees.

Recent surveys indicate the dramatic growth in the size of judgments and awards against cities. Based on a 1982 survey of 937 cities, the largest amount sought was $40 million. In 1985, the 1,244 cities surveyed responded that awards were being sought in the $100-$200 million range. Additionally, the number of lawsuits filed against public officials has doubled since 1982. Both the frequency and severity of liability awards have increased as well as reported in the recent national report on public officials liability done by the Wyatt Company.

Solutions to these problems are being actively considered by states, including the re-establishment of sovereign immunity, at least on a basis limited to certain defined activities; the adoption of better risk management activities (e.g., equipment maintenance, loss control plans); improved safety plans; the elimination of some hazardous municipal series (e.g., hazardous substance treatment or disposal); and limitations on recovery of damages sought in citizen suits.

ENVIRONMENTAL LIABILITY

At the center of problems associated with the availability of pollution liability insurance is the fact that liabilities against policyholders for cleanup, personal injury, and property damage are created by multiple federal and state statutes as well as by common law. Interacting with this are court interpretations of prior insurance contracts expanding coverage beyond that which insurers intended. As a result, availability of insurance for current pollution liability is significantly influenced by insurers' concerns about potential unanticipated past liability; the magnitude of potential pollution liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; the complexity and expense of underwriting the coverage; the unsettled state of the technology used to dispose and clean up toxic and hazardous substances; the fact that demand for coverage has been confined mostly to entities with a high probability of sustaining large losses, causing problems in risk spreading; and a civil justice system that continues to create new theories of liability and to expand older theories. Further adding to insurers' uncertainties, is that these other events occurred at a point in time when environmental impairment liability insurance was just beginning to be offered by relatively few writers and little claims data was available.

In discussing solutions, it is necessary to separate fundamental solutions from short-term transitory ones. Furthermore, solutions for one statutory problem may have relevance in other settings but require separate action. Amendments to the Federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the Superfund Law, also would be applicable to the state copies of Superfund (about 40 states). Moreover, amendments may be necessary to one law only to increase the likelihood of coverage under another. For example, one factor in the lack of available insurance to meet the financial responsibility requirements of the Resource Conservation and Recovery Act (RCRA) is the fear that today's RCRA sites will become tomorrow's Superfund cleanup target. It also must be recognized that sometimes two events converge to produce a problem. For example, the insurer problems with Superfund are the result of the provisions of the Superfund law, as administered by the EPA, interacting with state court decisions reading out coverage limitations or exclusions in insurance policies regarding pollution liability. Problems under the federal Superfund law include:

Retroactive Liability—The provisions of the Superfund law apply retroactively to owners and operators of waste sites, transporters, and those who generated waste disposal at the site.

Strict Liability—Liability exists even though the responsible party's acts or omissions were not the proximate cause of the leak and even though the substance leaking is not that deposited.

Joint and Several Liability—The majority of courts ruling have held responsible parties jointly and severally liable and ignored degree of contribution to the toxic site.

Excessive Transaction Costs—The present responsible party approach to Superfund combined with joint and several liability has resulted in high transaction costs. The monies spent by EPA could better be used to clean up sites while insurers have faced investigation and legal costs that frequently are far in excess of any potential Superfund cleanup share.

In general, the availability for pollution coverage has declined over the past several years to the point where some operators have formed captives or insurance companies. One example of this is the recently reported formation of Waste Insurance Liability, Ltd., which was formed by the National Solid Wastes Management Association.

I would hasten to add that this is a short-term solution. There is a need to address the long-term liability problem in this and other areas.

A recent study by the All-Industry Research Advisory Council (AIRAC) identified six general areas that are consistent with previous observations by the Alliance and other industry groups:

1. Some of the provisions and interpretations of federal pollution laws make it difficult if not impossible for the insurance mechanism to work. State pollution laws create similar difficulties in a few instances.

2. Courts in several key jurisdictions have imposed enormous retroactive liabilities on insurers for pollution damage and cleanup costs that were never intended to be covered. Insurers are concerned that the courts will not respect the intent of their future pollution contracts as well, no matter what language they use to describe the terms and limitations.

3. The reinsurance market for gradual pollution insurance has virtually disappeared because of adverse loss experience and concerns over legal trends in the United States.

4. Financial results for the U.S. property-casualty insurance industry as a whole in 1984 were the worst since 1906, the year of the San Francisco earthquake. Insurers as a group incurred $1.18 in losses for every $1 of premiums received and income. 1985 saw a continuation of these losses.

5. Demand for gradual pollution insurance has been confined mostly to entities with a high probability of sustaining large losses, causing problems for insurers in developing enough insurance capacity to handle the catastrophic risk involved. Insurers have yet to see the kind of broad demand that would enable them to build and sustain a robust market for the coverage, in part because the pollution laws have not been vigorously enforced.

6. The pollution hazard has turned out to be much more complex and expensive than anticipated. Gearing up to underwrite this catastrophic risk, it is now realized, requires major commitments of time and dollars, as well as expertise typically not available on staff.

MOTOR CARRIER LIABILITY

Against the background of generalized property/casualty insurer problems, the requirements for high limits of liability as mandated by the Motor Carrier Act of 1980 and the Bus Regulatory Reform Act of 1982 have placed a severe strain on the capacity of insurers and on their ability to accurately ascertain a financially sound course of action.

In addition to excessive financial responsibility, limits of these statutes, other reasons for the current problems include:

Deterioration in the quality of risks, particularly with regard to marginal operators and new operators who are less financially stable and have no safety record in their operations.

Further, a number of states including Colorado, Connecticut, Indiana, and Pennsylvania have enacted or introduced within the last year, legislation which extends the federal financial responsibility requirements to risks operating intrastate.

Solutions to availability problems include the redefinition of the types and sizes of motor carriers and passenger carriers required to carry the higher limits. In this context, an attempt should be made to exempt local carriers operating only intrastate from the federal requirements, leaving them to be separately regulated by the states. Other exemptions might be considered for carriers having only slight exposure to loss, based on maximum quantity and/or frequency or hazardous materials carried.

Insurers recognize the social and commercial necessity of their product as well as the integration of insurance with sound public policy. The underlying problems in the environment of certain businesses as reflected in availability and affordability problems for certain coverages, deserve thoughtful solutions by insurers, their policyholders and public policymarkers. These problems do not exist in all lines of commercial insurance, nor in all states nor to the same degree in each affected commercial activity. The prospective solutions vary in their applicability to each such problem and to segregated geographical areas where the problem has surfaced. What is clear is that the solutions should not be limited to insurance. What is needed in nearly every such troubled line is a stable business and legal environment. What is required to achieve that varies by the nature of the underlying problem.

We of the property/casualty insurance industry are working with insurance departments and affected businesses and individuals in all of those states where problems have been identified. We are not in the business of not providing insurance. It is in our interest to do so and it is right as a matter of sound public policy that we do so.

We believe that solutions will come but that change is necessary. What all of us want is available and affordable liability insurance.

Efforts are now being made by policymakers on various levels of government to address this problem.

We thank the Subcommittee for giving us the opportunity to share our concerns and want to indicate our willingness to work with this Subcommittee and other Committees of the Congress to assist in an understanding of the problems and solutions in the area of availability and affordability of liability insurance.

Mr. Anthony. Thank you.

It is a pleasure to have a fellow Arkansan to testify. Welcome.

STATEMENT OF MIKE THOMPSON, PRESIDENT, THOMPSON INSURANCE AGENCY INC., MOUNTAIN HOME, AR, AND MEMBER, EXECUTIVE COMMITTEE, INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

Mr. Thompson. Top of the morning, Mr. Chairman.

I am Mike Thompson, president of Thompson Insurance, from Mountain Home, AR; and I also serve as a member of the executive committee of the Independent Insurance Agents of America [IIAA].

We represent approximately 126,000 licensed agents comprised of 32,000 agencies, and about 220,000 employees. Our members sell and service all lines of insurance, but we are primarily involved in the property and casualty business.

At the outset, you should know that the insurance agents of this country are among the groups hurt by the insurance availability situation. The product we sell is scarce. This scarcity affects me and my colleagues as it does our customers.

I am not here today to engage in an ideological debate between trial lawyers and the insurance industry. Polemics won't solve the problems my clients and your constituents are having finding insurance at an affordable price.

My prepared statement outlines several areas that we have as concerns IIAA, such as tort reform, company pricing practices in the past, reinsurance markets, and the need to strengthen our system of State regulation.

Today, I would really like to confront head on some of the charges that have rendered more heat than light on the insurance issue and tell you what the real world looks like from the front lines of the insurance marketplace. Some have said that the McCarran-Ferguson Act allows companies to conspire to set prices and, therefore, control the marketplace. This is a mistaken view. The McCarran Act does allow limited trust exemption to the industry which, in practice, allows smaller companies to benefit from the pooling of actuarial information that they would simply not be able to afford themselves.

This limited exemption thus fosters competition by allowing the smaller regional companies to compete with the larger companies.

Nothing in the McCarran Act would allow the industry to boycott certain lines of coverage. Since the act already prohibits such practices, there is no need to amend it.

Some have said that the industry needs some form of Federal regulation. I would like to mention that IIAA vigorously supports strengthening our system of State regulation.

Why would a Federal regulator have more wisdom or political will than a State insurance commissioner? When the companies were engaged in cash flow underwriting during the high interest years, we did not hear anyone complaining that rates were too low. I submit to you today that no regulator in that climate would be able to withstand the onslaught of public opinion, and possibly political fallout, from issuing a directive to insurance companies to raise prices.

As to direct Federal intervention, we have history as a guide. In each of the areas where the Federal Government has directly intervened in the business of insurance, that intervention has produced not insurance coverage but direct Government subsidy paid for by our taxpayers.

Crop insurance, crime insurance, and flood insurance are insurance in name alone. They have each proven to be a failure from an economic point of view. And there is no reason to believe this will change now.

There is a movement here on Capitol Hill to do something about the situation. And while we, as agents, understand the perceived need for action, we must stress that great care be taken at arriving at the solution.

Several bills being considered by the House and Senate would expand the use of risk retention self-insurance mechanism beyond the present confines. This so-called solution could possibly lead to bigger problems if not implemented carefully.

Insurance spreads risk, in a sense erecting a financial safety net under the purchaser. Self-insurance, or risk retention, on the other hand, by its very definition, retains the risk.

We have all seen the experience of the so-called medical mutuals set up to allow doctors to purchase affordable coverage outside the traditional commercial marketplace. They have largely failed because the same forces that drive up the cost of insurance in the regular markets work their will on the self-insurance pools.

It is illusory to expect to opt out of the real world where doctors and others are called to account in the courts, and as long as the legal system continues to operate as it does today this fact will be true.

I would be remiss today if I failed to mention that in one particular line of coverage, environmental insurance, the use of joint and several liability as an enforcement tool has eliminated the private market completely. I know this committee is concerned about the tax aspects of the Superfund reauthorization debate, but joint and several liability is the culprit here, not conspiracy.

I am also aware of the frustration that Congress is experiencing in getting timely and relevant data from the industry on the availability issue. While we understand some of the company problems in this area, insurance agents share a measure of your frustration, also.

The IIAA executive committee has completed a series of meetings with the chief executive officers of some of our industry's leading companies, and we requested that they develop the data necessary to illustrate their problems with the tort system. We are in hopes that they heed our request.

Mr. Chairman, we are in the business to sell insurance to the public, not to deny it, because insurance is a necessity in our litigious times. Some people think of our product as a right akin to a public utility, rather than a commodity subject to the market forces of supply and demand. I can assure you today that independent agents nationwide yearn for a stable and financially sound marketplace which will reflect the best interests of our customers.

Thank you.

[The prepared statement follows:]

STATEMENT OF MIKE THOMPSON, CIC, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

Mr. Chairman, I am Mike Thompson President of Thompson Insurance Agency, in Mountain Home, Arkansas. I am also an Executive Committee member for the Independent Insurance Agents of America. As an insurance agent, I represent both insurance companies and the consumer—a position which permits a broader perspective on this and other issues otherwise common to the insurance industry.

In the brief time allotted, I'd like to outline a number of contributing factors to the availability/affordability crisis, and suggest some possible remedies.

Tort Trends: There's no getting around the fundamental importance of the tort issue. Whatever else may have contributed to the current crisis, and whatever else may be done to seek improvements in insurance markets, the long-term insurability of risks rendered uninsurable by the courts and law will only be restored by changes in the tort system. Such changes need be neither dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair. But a national reevaluation and reform of the concepts of fault, compensation, and evidentiary standards—to name just three—is reasonable, and could go a long way toward restoring the predictability, and therefore the insurability, of certain risks. Two more points about tort reform: (1) tort reform is a necessary but not sufficient response to the insurance availability and affordability crisis, and (2) it is not only an insurance issue. The country's tort system needs reform quite apart from the direct effect such changes might have on insurance markets.

Reinsurance Markets: The big missing link in today's insurance markets is reinsurance: the insurance insurance companies carry to permit coverage of large risks. The absence of this reinsurance capacity contributes to reduced overall availability and lower limits of coverage. Reinsurers' confidence has been shaken—or so they tell us—by the unpredictability of contract interpretation. And a return to American markets by reinsurers—again, we are advised from across the Atlantic—will be facilitated through use of a new "claims-made" contract which attempts to limit exposure strictly to the term of the policy. Finally, reinsurance costs, since they are largely uncontrollable, are a big factor in the affordability of insurance now available.

Insurance Company Management: Having acknowledged the effects of tort trends and reinsurance on today's markets, the insurance industry must be clear-eyed and candid about its own contribution to the current crisis. By this I mean what one insurance company commentator characterized as ". . . a price cutting binge (when double-digit interest income could offset underwriting losses) totally unjustified by loss and expense experience and totally at odds with the need for reserve and surplus strengthening.

"The industry," this unusually candid insurance company representative continued, "has paid a terrible price for the folly of 'cash-flow underwriting.' It has weakened its public credibility and sapped both its financial strength and that of the reinsurers of whose inexperience and naivete it was so willing to take advantage."

Another largely controllable reaction to the real availability crisis in lines of insurance such as environmental liability, has been to treat less obviously troubled riks with the same defensive mentality. To be sure, steps must taken to shore up reserves and protect against future, unsustainable losses where the courts and laws have conspired to render risks uninsurable. But not all risks have been similarly undermined, nor all underwriting made as unfathomable as the celebrated examples of pollution and professional liability. As my national association's President, Mr. Richard Taylor, recently remarked: "Underwriting is the science of trying to find a way of writing a risk—not trying to find a way to get out of writing it. It seems now the underwriters are trying in most cases to find a way to get out of writing a new piece of business." No amount of changes in the tort system or in reinsurance availability will prevent the persistent recurrence of today's crisis if not accompanied by industry reform of pricing and underwriting policies.

Economic Trends: More than most industries, insurance—because of long-term exposure, reserving against future loss, and claims losses—is affected by swings in the general economy. As the criticism of insurance company pricing practices in a high interest rate economy imply, the dramatic drop in interest rates over the past few years has taken its toll on insurance company profitability and surplus. All the more reason for the industry to avoid exaggerating this natural vulnerability by ill-conceived pricing and underwriting decisions.

Claims Losses: Statistical arguments are always slippery, but insurance industry statistics show an industry-wide net operating loss last year for the first time ever—and we believe them. Others' statistics reach different conclusions, and, beyond a rudimentary level of understanding quickly reached by those of us unschooled in the actuarial sciences, it is frankly difficult to know what ultimately will come of this furious debate. As an insurance agent, I know what I see in the market, and I see many of my companies hurting financially—in part from the self-inflicted wounds of price-cutting a few years back, but in part too from economic circumstances beyond their control. Until an objective, knowledgeable statistician can be called in to sort out all the numbers, the existing statistical evidence should signal caution in drawing firm conclusions or pursuing policy decisions which could further weaken an already financially strapped industry.

Competitive Marketplace: Although highly regulated, the insurance industry is a member in good standing of the competitive, relatively free market. From this fact, a couple of general points should be made: (1) short of turning the insurance industry into a public utility of mandated, take-all-comers coverage, it is simply an economic fact of life that not all risks will be insurable at all times, or at low prices, and (2) criticism of, and proposed solutions to, insurance industry "cash-flow" underwriting bump up against this free market fact: the decision to offset underwriting losses with high investment income was also a decision to pass along to the consumer the benefits, in lower prices, made possible by that market. What would public reaction have been if at the time of record interest rate investment income the insurance industry had not competitively lowered the price of its product? These are the quirks and complexities of the competitive marketplace which must be taken into account.

With that outline of the multiple causes of the availability/affordability crisis, what can be done to help improve the current market?

At the federal level, very little. Where the federal government has offered insurance directly (flood, crime, riot, crop), the results have been costly and inefficient. Where it has mandated liability limits or created new exposures (trucking, pollution liability), the results have been to intensify market distortions. And where it has attempted, thus far unsuccessfully, to impose national standards of coverage (health and auto no-fault), the prospect of raising to a universal level the potential high costs and market dislocations which might otherwise be limited by state experimentation has been enough to dissuade past congresses. There are two areas, however, which may require or benefit from a federal approach. The first is federal product liability tort reform, probably necessary to account for the flow of products in interstate commerce. The second is amendments to the federal Superfund law (CERCLA) to facilitate the restoration of now unavailable pollution coverages by eliminating retroactive liability for risks never contemplated in pre-CERCLA insurance contracts, and by modifying the joint and several liability now imposed under CERCLA.

In the states, two avenues should be pursued. First, state-by-state tort reform to address in a modest but effective way the tort issues which may have the greatest long-term effects on insurance markets: costs of litigation, apportionment of fault, punitive damages, and others which may fit into individual state law contexts.

Second, state regulators now have the authority to ensure that insurance rates are neither inadequate (too low), excessive (too high), or unfairly discriminatory. That existing authority should be supported and used. Specifically, IIAA recommends and supports regulation for company solvency, including disclosure of financial data and the strengthening and protection of state guaranty funds. We also support regulations requiring advance notice of mid-term cancellation, non-renewal, and premium increases.

Finally, in the market, we encourage, and are establishing through many of our state associations, voluntary, market assistance plans to help hard-to-place risks find coverage. Also in the market, although not universally endorsed by our state associations, and still an unknown quantity in terms of marketability and restoration of reinsurer participation in American markets, the new, industry "claims-made" form may help provide coverage where there is none now, and should be given a chance to work.

Mr. Chairman, insurance availability is a complex problem and there is not a single cause nor, a simple cure. Insurance agents stand ready to help you and other members of congress better understand this issue, and pursue short and long-term remedies which reflect the public's interest in having a competitive, financially sound insurance industry. Thank you—I'd be happy to answer your questions.

STATEMENT OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC. ON INSURANCE AVAILABILITY

The current crisis in insurance availability has placed severe economic pressures on the insurance buying public, since insurance has become a necessity for operating a business, hospital, school district, or other organization.

As insurance agents, whose primary responsibility is to help our clients obtain the insurance coverage they need, we are deeply concerned by the present availability crisis, and have dedicated ourselves to a variety of endeavors to help alleviate this problem.

ACTION TO DATE

Big "I" state associations, working with IIAA, have devoted considerable energy to keeping their agents informed of available sources of insurance for those types of risks which are now difficult to obtain, and these affiliates are working directly with individual insurers to arrange coverage for broad groups of risks, such as day care centers. In instances where insurance has become unavailable in the conventional marketplace, IIAA state associations have worked diligently with insurers and insurance departments to set up voluntary Market Assistance Plans to help meet the needs of agents and insurance buyers.

In addition, IIAA, through its Electronic Management Information Service (EMIS), has made available an innovative Market Access Program in which IIAA members around the country can electronically post information either on available or needed markets.

Responding to critical developments in pollution coverage, which is virtually impossible to obtain in today's marketplace, IIAA established a pollution task force to examine the problem and to meet with legislators and industry representatives to develop viable solutions. Since it was established in March, 1984, the task force has met frequently with concerned parties from affected industries and has developed recommended actions to improve the law and insurance markets covering environmental impairment. The task force will intensify its efforts to encourage insurers to provide coverage in this market.

IIAA has also conducted several surveys to help identify markets for difficult-to-place coverages. The Independent Agent Magazine has already completed surveys of pollution liability, surplus lines, D&O, and farm markets which have been published and plans to conduct additional surveys to identify markets in other critical areas.

ACTIONS NEEDED

IIAA strongly believes that all facets of the insurance industry—insurers, agents, brokers, regulators—must intensify their efforts to help businesses secure necessary insurance coverage at a fair price. The industry's credibility with the public and government hangs in the balance. Toward this end, members of IIAA's Executive Committee have and will continue to meet with insurance executives and representatives from other industry groups to stress the absolute necessity of keeping markets open and to formulate practical approaches to return insurance capacity.

IIAA is also working directly with the business community through the National Federation of Independent Business, the Small Business Council, the Chamber of Commerce, and other industry associations to assist them in meeting the insurance needs of their members. IIAA intends to increase this activity.

More, however, needs to be done. IIAA and its state associations believe that the judicious use of state regulatory authority can alleviate today's market conditions. IIAA commends those states which have taken action to limit mid-term cancellations and premium increases, and to require adequate notice of cancellations, non renewals and premium increase. It recommends that other states consider similar regulations.

Similarly, it supports action by states to produce timely date on the financial status of insurers, and to protect solvency.

In addition, IIAA urges insurance companies to plan and implement pricing and underwriting strategies more carefully, and chart a more stable, economically sensible course which they can sustain over time. Insurance company over-reaction to natural swings in insurance markets—by underpricing when times are good, followed by efforts to make up lost ground too quickly when markets tighten—have made a bad situation worse.

Moreover, IIAA urges companies not to withdraw from entire lines of insurance just because there are problems with individual risks within those lines. Rather, companies' underwriting should distinguish between risks, and company resources should be devoted toward satisfying customer needs.

However, these steps are only parts of the solution. In the long term, permanent improvement in insurance availability will only occur if the liability exposures insurers underwrite on behalf of businesses become more predictable. Today, insurers predict that the changes taking place in the tort system will continue to accelerate—resulting in new theories of liability, court restructuring of insurance policy language, and an erosion of defenses to liability. These predictions for continued liberalization in the tort system, combined with the huge jury awards that have been given in some cases, understandably have had a chilling effect on insurance underwriters. IIAA and its state associations pledge to work aggressively with legislators and other business groups to seek reforms that will restore balance and fairness to the tort system.

So long as clients of independent agents have difficulty securing the insurance they need, IIAA's first priority will be to improve insurance markets.

Mr. ANTHONY. Thank you very much, Mr. Thompson.

At this time, Mr. Schulze will be recognized for 5 minutes.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Thompson, you said that if we are going to expand risk retention, we should do it carefully.

I would like to ask you and the entire panel whether there is any way in which you see that we could expand the Risk Retention Act of 1981 so that the insurance industry could actively participate in reinsuring and perhaps even offering management services to retention groups to try to ensure the success of such expansion?

Mr. THOMPSON. Fine. Thank you.

When I say "use care," I have to look back in my time in the insurance business at some self-insured risk that did not take long to fail, because of the same problems followed by our normal insurance delivery system. And when I say be careful and cautious, we do not object to risk retention, based on the sound practice of being able to monitor it on a day-by-day basis, and that is why I think we probably will have to work through the National Association of Insurance Commissioners so that the pulse can be felt on a State level, so possibly we can do some changing before things get in trouble, because several have.

Mr. **Farmer**. Congressman Schulze, you made that challenge to the industry several weeks ago: What particular role could the Tax Code play, for example, in solving this whole process?

Going back to my first thought, which wasn't a very good thought, I figured that you might be able to give a tax credit to some of the people who are experiencing a rise in liability insurance costs; and I thought about that for about 3 seconds and decided that probably wasn't the way the committee was going to go.

There may be a way. And I have asked that question to several people. How can——

Mr. **Schulze**. Let me inject, one of the things I have been thinking about is giving those small businesses which have never had a claim some kind of a tax break to encourage them to self-insure.

Mr. **Farmer**. When we talk about risk retention, one of the things that we in the industry know from past experience that can be fairly well documented, is that if doctors form a company simply to write malpractice, you do not have—you don't have a spread of risk in that particular line of insurance, and generally they go into it with the idea that they have been charged too much in the commercial insurance market.

And I think given the current tort system, that what we are concerned about is down the road, since it takes a while for these things to develop, is that you end up with a situation that, instead of helping people, that 5 years from now those risk retention groups could be experiencing some particular type problems.

Nurse midwives are a good example. They are having difficulty finding a market, so perhaps they want to form a risk retention group. They can only afford to pay so much for insurance, so they may not have enough.

I am not picking on nurse midwives, but any other group, and so that is why care needs to be taken to make sure that people just don't form a mechanism in the hope that this will address their problem, because short of addressing the fundamental problem in the case of malpractice and others is the tort system, and a risk retention will over the long pull not be an answer.

Mr. **Schulze**. Let me ask this also of the entire panel.

I know you don't speak for the entire industry, but would your industry be willing to sit down at a table with the ABA and the trial lawyers and try to work out areas of agreement or compromise on tort reform and other areas that are bringing on this crisis?

Mr. **Crosby**. Mr. Schulze, there have been several recommendations to that effect already. The Institute for Civil Justice, which testified before you last Thursday, has proposed a Blue Ribbon Commission on Mass Torts and their impact on the civil litigation system.

Commissioner Fletcher Bell of Kansas, the insurance commissioner, last week at the NAIC meeting in San Francisco formed a Legal Liability Task Force which is trying to bring representatives of all the major groups that you mention together at one time to talk about the tort system. So, your ideas are very timely and I think would be welcomed by the industry.

Mr. SCHULZE. Do you think we can get anywhere?

Mr. CROSBY. I think so. I am always hopeful that sitting down and talking about problems is a better solution than the acrimony you have heard today.

Mr. ANTHONY. Mr. Crosby, not only Mr. Nader and Mr. Hunter have been asking a lot of questions and maybe shooting from the lip, but you have a lot of politicians around the country that are shooting from the lip, as well as the hip. They are responding to their constituents who are calling them, writing them letters, saying, "I either can't get insurance or it has gone up so high this year I have been priced out of the market."

I asked a question earlier, whether or not they would be willing to provide the same type data that Mr. Nader has requested, and that is the amount that has been set aside for future reserves and on a line-by-line basis so we can compare that to premiums collected, losses paid out, and other the costs of doing business. Then we could make some rational judgment.

Do you have a suggestion as to how we could go about obtaining that data?

Mr. CROSBY. Much of that information and data is already available. The Insurance Services Office out of New York, A.M. Best and other statistical agents around the country, have some data. It may not be broken down quite as specifically as Mr. Nader or Mr. Hunter might want. A closed claim study, which would cost a great deal of money, could be instituted, and that would help answer these kinds of questions.

But I think the insurance industry is willing to undertake providing as much data as possible. As I said earlier, we already provide a great deal of data to various regulatory entities.

The one problem we have here, in looking at a particular insured or a particular claim and trying to attribute that to some element of tort reform or another, is like looking at a good candidate for public office. You may be a terrific campaigner and Congressman, but the entire ticket might bring you down.

The insurance industry can't look at one claim or one insured. The entire breadth of our potential claims could bring us down.

Mr. ANTHONY. Let me bring up something else—mid-term cancellations. Now, I know the insurance company notifies these independent insurance agents and they have in turn, tell their customers that their policy has been cancelled. Sometimes it is done in broad classes where these classes should be actuarially sound. Some of the other witnesses' testimony talks about this.

Why is that practice pursued in the industry?

Mr. CROSBY. Well, first of all, in many instances the mid-term cancellations are provided for in the insurance contract.

Mr. ANTHONY. I understand that they may be legally provided for. I am talking about morally and practically, why in the hell do you do it?

Mr. **Crosby**. Practically, they may see a potential loss there that they would like to restrict, if at all possible, so they could remain solvent. Many of the States, in response to this availability crisis, have instituted stricter procedures with respect to nonrenewals and mid-term cancellations.

Most of the representatives here are participating in drafting model regulations to morally and more practically deal with the mid-term cancellation and renewal problem.

Mr. **Anthony**. I am proud to hear you say that, because this is the reason there has to be some type of Federal oversight, because you got 50 different State regulators that take a different viewpoint.

We would all like to be insured, and yet it depends upon what State you live in as to what kind of cancellation protection you have.

Mr. Thompson, you represent the gentlemen and the ladies that sell insurance. Do you have any comment for the record on that?

Mr. **Thompson**. I have to tell you that I not only am the delivery mechanism for the product, but also a sizeable consumer, and find my marketplace entered sometimes, also.

We simply are interested in a fix, if you will, for the situation we are in. We will be glad to work as hard as we can as agents, with our national association, to lend any hand that we can.

We think that there are some long- and short-term things that need to be done; and, of course, through the long-term only some modification of our tort system probably will bring predictability, and therefore insurability, back to some lines.

But I can tell you that our States and our national association are working closely with the regulators to limit these mid-term cancellations, price increases.

I have in my packet a letter from one of my company managers recently filed by the Tennessee Commissioner to do such, and he agrees with it totally.

Mr. **Anthony**. One final question to the panel as a whole.

Do you feel that each and every State Insurance Commissioners Office is fully staffed, fully up to speed, expertise-wise, to be able to render a quality oversight of the insurance industry? Or are there areas there that need to be addressed?

Mr. **Farmer**. Several answers, I think, to that question.

The industry does pay in the way of premium tax a substantial amount of money. The number of personnel that is assigned to the insurance department is the responsibility of the Governor of an individual State, and we would certainly hope that the moneys that we pay either in premium tax and in fines and penalties all go back to the insurance department.

As a practical matter, they don't always do that. So, the decision of an individual State as to whether they want one or two or three actuaries, or three lawyers, or the Attorney General's Office to handle their legal affairs, is a matter for the individual State. However, because of the existence of the National Association of Insurance Commissioners, even the States that don't commit resources get the advantage of what is happening all across the country.

And also there are leaders in regulation. They see that the California Department or the Illinois Department or the New York Department or the Florida Department have large staff, what they are doing. And so there is that uniformity in the sense that what the larger States are doing, the smaller States will eventually do as well.

So, because you don't necessarily have resources in one particular State, because they have chosen not to appropriate the funds, they are still getting the advantage of what other States do.

Mr. **Anthony**. I think Melvin Belli needs to interview you. You can argue it round or argue it flat. You might make a good associate in his firm. I am looking for a good straightforward yes or no.

But, my time has expired.

Mr. Guarini.

Mr. **Guarini**. Following up, all the insurance companies have a separate set of reports when it comes to paying income tax because they must comply with the Federal Code. But there are 50 separate States with their own insurance company laws.

How uniform is it among these 50 States as to their bookkeeping procedures and their profit and loss statements they require the insurance companies to make?

Mr. **Farmer**. Annual reports, there is for State regulators—there is uniformity. It is essentially the same report.

Mr. **Guarini**. Any diversity as to the way reserves are kept, how rules and regulations affect the balance sheet so there is not total uniformity? If I look at the balance sheet from Arkansas and one from California, would I have to ask a lot of questions about regulations before I can come to an answer as to how surpluses are used, et cetera?

Mr. **Farmer**. Not on the annual statement, but in rate filings there might be some differences.

Mr. **Guarini**. So, therefore, there is a lot of diversity if we really examine the reporting system?

Mr. **Farmer**. There is diversity.

Mr. **Guarini**. Do you think it would be healthy if that would all be uniform throughout the country so that a man who writes insurance in New York, and another one in Florida, and this insurance business is crossing State lines all the time, that there should be the same kind of bookkeeping that would be uniform so that the regulations could be understood to be evenly administered between States?

Mr. **Farmer**. Uniformity is certainly—it certainly can be helpful in some instances. However, what one State chooses to do for one particular reason ought not necessarily be what everyone does.

If there is a problem in medical malpractice in State X, and the regulator in State X wants some additional data, why should you have to file that in 48 other States if there is no problem?

Mr. **Guarini**. I don't mean file it. I just mean that the bookkeeping process be totally uniform, to comply with uniform regulations.

Let me move on.

Is there any reason why premiums for malpractice, and product liability, and in other areas, should not be regulated as public utilities are regulated, and how often is automobile insurance regulated?

Mr. **Farmer**. I guess I would respond, and let others respond. Should we regulate contingency fees like a public utility?

Mr. **Guarini**. No; you are comparing apples and oranges now. Contingency fees are a lot different from the fees that would be charged uniformly by insurance companies. We do it in automobile insurance very widely. We don't do it in all these other instances. So, therefore, an insurance company can come forward and say, "Day care center, your fees are going to be 8 or 10 times what they were in the last year;" or, "Mr. Manufacturer, we are going to increase your manufacturing liability, for product liability, 6 times over last year."

Why shouldn't there be uniformity?

Mr. **Farmer**. Insurance companies have to justify rates.

Mr. **Guarini**. But all they do is justify notice.

I am saying, if we regulate gas and electric, which is a reality of life, as an insurance company is a reality of our society, why not regulate the insurance rates as we do utilities?

Mr. **Crosby**. If I may respond, some States do regulate every aspect of the premium related to medical malpractice or other lines of insurance, whereas in a State like Illinois, where we are based, they have open competitive rates for all lines of insurance.

The availability crisis is across the entire system, whether you have a prior approval system, file and use system, or open competition.

Mr. **Guarini**. I know that because of the way the regulations are widely administered, insurance companies often justify notice that this is going to be our premium for malpractice. But they are not looked into as closely as they are in automobile insurance.

Should we regulate all insurance as we do utilities?

Mr. **Crosby**. I don't think they should. I think where competitive rating is in existence, rates have tended to be lower for the consumer. And the FTC study last year concluded States where there is file and use, as opposed to competitive rating, rates have tended to be higher.

Mr. **Guarini**. Insurance companies should be allowed to multiply rates by 10 times, if they so see fit. Say I am a doctor; I have no malpractice case against me in 30 years, but a guy down the street, he has 12 cases against him. Why should I pay the same that he pays?

Isn't this indigenous to your system, this distortion of thinking?

Mr. **Crosby**. Well, that is the——

Mr. **Guarini**. There is no risk on me. And yet, I may have to go out of business. Yet, I can't pay the high cost of malpractice. And I am a good practitioner.

Why shouldn't I get a premium that would reflect that?

Mr. **Crosby**. You are free to go bare, but the whole nature of insurance is to spread risk. And that is why the person down the street may balance out your good claims record.

Mr. **Guarini**. Well, let me ask you, you said that we accept our fair share of responsibility for the crisis. That was in your statement; is that right?

Mr. **Crosby**. Correct.

Mr. **Guarini**. What are those responsibilities that you accept? Where have you gone wrong and made mistakes as an industry? And will you lower premiums? And will you expand coverage?

Address yourself to those.

Mr. CROSBY. That is a full platter, Mr. Guarini.

Mr. GUARINI. This is your statement.

Mr. CROSBY. I believe insurance companies should provide coverage at a fair and reasonable rate, given the potential risks involved in that particular line of insurance, and that particular insurance——

Mr. GUARINI. I asked you—you said we accept our share of the responsibility for the crisis.

Where have you gone wrong? Where have you not lived up to your responsibility as an insurance industry? And will it help lowering the premiums if we make these corrections and help to expand coverage?

Mr. CROSBY. We have stated that, through cash-flow underwriting and some of the cutthroat competition that took place over the last several years, perhaps we have gone wrong.

If we restore some balance and fairness to the civil justice system, I do think you will see rates moderate and availability of insurance——

Mr. GUARINI. I asked you on the part of the insurance company—not to slip it over to the tort system all the time—what rules and regulations should we pass? Should we do this from a Federal level then, to make sure you don't do it again?

Mr. CROSBY. I did not state that, and I am not advocating Federal regulation of the insurance industry, nor is our association advocating any tort reforms on the part of the Congress.

Mr. GUARINI. All right. Thank you.

Chairman PICKLE. What is a business organization or a State and local government entity or a volunteer organization to do if insurance premiums have increased 100, 200, 300 percent? Do they just pay it? What happens?

Your premiums have been going up in that neighborhood, and in some areas a lot more.

What does that business person do when the premiums have gone up 100, 200 percent?

Mr. SKUPA. There are some things that are occurring now that they can limit some of their coverage through a claims made policy. There are other areas that they can reduce their expenditures and limit the deductibles, this type of thing, that will help.

Chairman PICKLE. You gentlemen are in the business. Have the premiums gone up with the clients that you serve considerably in the last 3 or 4 years?

Mr. SKUPA. In the last year to year and a half, they have increased——

Chairman PICKLE. Have you lost any business because the premiums have gone high?

Mr. SKUPA. Yes, sir.

Chairman PICKLE. What does that person do with no insurance, then?

Mr. SKUPA. He has the choice of going out to try to find other coverage from other companies. And, for example, in Indiana, which I didn't realize until this morning, that we were maybe underprivileged on the ability to sue, but we did develop a market assistance program there in January.

To date, this program has handled approximately 205 telephone calls questioning where they could buy coverage; also about where they could buy it at a better rate. Along with this market assistance program we offered any of those 205 people to submit applications that we have companies that will voluntarily accept the coverage. To date, not a one has responded to that. So, largely, a lot of this is questioning of where coverage is and what is available.

Chairman PICKLE. You are saying, then, to an individual that if your premium gets so high that you feel like you can't pay it, someone has formed a voluntary organization to receive phone calls, and we will help you find a company that will insure you.

At best, that is a sort of a temporary answer, isn't it?

Mr. SKUPA. It is until we can level off——

Chairman PICKLE. What happens if the premium goes up some more and more? One company is not going to vary that much from another company.

What does a man do when he gets to the point when he cannot get insurance? What does he do then?

We already know in some fields like pollution, asbestos, some environmental aspects, they cannot get insurance at all.

Mr. FARMER. On a State level, they are pushing to expand these joint underwriting associations to cover some of those things, to force us to cover some of these exposures that we won't voluntarily do.

What can people do? First, try and determine what the source of their particular problem is. If you are operating a hazardous waste facility in connection with a bus company, I think I would want to try and get out of dumping my own waste.

I am talking as a business person, where are your losses coming from?

Chairman PICKLE. What does the physician do? An oral surgeon has seen his premium go in some cases up to $60,000 or more a year. Do you expect him to pay?

Do you sell insurance to any physicians?

What do you do?

Mr. THOMPSON. Mr. Chairman, thank you.

I would like to point out that while we are involved in a major crisis in this country in the availability line, that we do not need to forget that there are some things that are not broken, and we should not try to fix all of them because there are many people in the country that are buying insurance at a fair price. And it has been oppressed in the past, but if we look at the normal inflation schedule, many people are still paying an equitable price.

There are those particular lines of insurance that are very difficult. And I would ask you to keep in mind that everyone has a problem.

I do a lot of business with the medical profession, and in all States. They are also not having problems.

Chairman PICKLE. Well, I would agree with that. I don't think the committee ought to assume that everybody has been priced out of business. That would be unfair.

As a person who is a member of this body, I go home, and doctors, lawyers, small business people, architects, you name it, are all saying their premiums have been doubled, tripled, or more. And almost 25 percent of them may be going without insurance. I don't think anybody knows the full extent.

If that is so, I don't think it is enough to say we got a good thing and you ought not fix it if it is not broke. It is either broke or it is going on one cylinder in many areas. So we must be honest with each other. You have to recognize that in your case, you are selling premiums, and they are increasing, doubling, going up and up.

So, I think we must look at it from a Federal standpoint, not for regulation, but to determine what can be a better answer.

It is tough. And we are going to have to find insurance somewhere else.

Mr. FARMER. There is something broke. The civil justice system in this country is broke.

Chairman PICKLE. You think that is a major problem?

I appreciate your comment.

Mr. CROSBY. Mr. Pickle, we have to recognize, and I would hope the subcommittee would recognize, that some risks are uninsurable and unaffordable, and we can't cover everything from the private sector. These risks are like recipients of former Federal grants or contributions, which, due to the budget crisis you are facing here, has resulted in some people not getting the funds they deserve.

The same is true in the insurance industry. Some of the risks like environmental, hazardous waste, asbestos and toxic torts may be uninsurable as far as we are concerned.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. I hate to let you go without asking my standard questions.

The civil justice system is broke and, therefore, Mr. Farmer is asking for it to be fixed. I assume you are asking for it to be fixed on a national level but not on a State-by-State basis.

Mr. FARMER. No, sir.

Mr. ANTHONY. You are asking for it to be fixed on a State-by-State basis?

Mr. FARMER. No, sir. We are asking, since States currently do determine the vast majority of rates and remedies of their citizens, that they continue to do so.

Mr. ANTHONY. You don't support national tort reform, then?

Mr. FARMER. We do not.

Mr. ANTHONY. Does anybody on the panel support it?

Mr. Skupa, has your association taken a position on national tort reform?

Mr. SKUPA. Yes. We would prefer State by State.

Mr. ANTHONY. Tort reform. You took a little lick at the regulators, but you still want it on a State-by-State or national basis?

Mr. THOMPSON. We prefer to see it on a State-by-State basis.

Mr. ANTHONY. OK, what do you get in return on a State-by-State basis? If you are going to cap pain and suffering, and do away with collateral source rule and eliminate joint and several liability, and a sliding scale for lawyers' contingency fees, whose premiums are going to be lowered, and by what amount? What additional lines of insurance will your company members go into as a result of the tort system being more stable in the future, and more predictable in the future?

Mr. **Skupa**. I guess if we could answer all that we wouldn't have any problem in our State-by-State approaches to this.

But it is very difficult. Some States do have a better climate in the judicial area than others and maybe not a total reform is going to be calculated on the basis of how much it will save anyone, because it is an unknown.

As you fix one area, something else develops. But there is enough competition in the property casualty insurance industry that if there is a hope of making a profit—and I think we have been referred to as greedy—if there is any way that we can see that we can reasonably have a chance of making a profit in any given line, there is going to be competition out there for it.

Again, the dollars and cents I don't have.

Chairman **Pickle**. Any other questions?

Mr. **Guarini**. Just to follow up, Mr. Chairman. The losses, Mr. Skupa, are not even throughout the Nation. I would assume, as you said, some States are more efficient and more advanced than others, and perhaps the loss ratio in California may be different from Colorado or Delaware, whatever.

Is that a fair statement, that the loss ratios are different? When you give averages, you are talking about all of the United States, generally speaking, so that there are some areas that are more disproportionate than others concerning the large judgment losses, and so forth. Is that fair?

Mr. **Skupa**. Yes. One of the problem right now is a lot of these small lines that are having difficulty, when you look on a State-by-State basis, it produces such a small volume and number of risks it is difficult to take that individual state, and you really need a nationwide experience to develop a predictable rate on it.

Mr. **Guarini**. Would it be a doctor in Colorado maybe subsidizing a doctor in California concerning malpractice insurance, because the judgments are bigger in California, and that doctor is really paying for the other person, and it is a distortion of the system?

Mr. **Skupa**. Not in the area of doctors.

Mr. **Guarini**. Let's say any other kind of insurance, whether it be automobile or product liability.

Do we have a distortion in the figures, whereby—maybe we should make everything uniform so everything becomes equal, so there is no distortion. But is a person who is paying insurance in one State subsidizing, because of the differences in figures, a person in another State?

Mr. **Skupa**. It would be minimal, overall, because most of the States do take their own loss results and expense ratios and calculate their rates from——

Mr. **Guarini**. Is that the sense of the rest of the panel? Because, as I understand it, there is a big disparity in judgments between advanced tort States and other States that are more backward.

Mr. **Farmer**. Mr. Guarini, it would be accurate to say there is some cross subsidy in the ratemaking process.

Mr. **Guarini**. That shouldn't happen if we want to be fair or just if we can eliminate it, is that correct?

Mr. **Farmer**. To the extent you can eliminate that, it probably should be eliminated.

Mr. **Guarini**. Thank you.

Chairman **Pickle**. I thank you gentlemen very much.

Mr. **Guarini**. Mr. Anthony and I want to jointly ask this one question.

If there is distortion, is there a distortion in your portfolios concerning liability losses with one kind of insurance and with another kind of insurance?

Do people—and Mr. Farmer, you testified you do health insurance as well as automobile and other kinds of insurance—do people in your portfolios subsidize people in other parts of your portfolio because of the different form of insurance that is written?

Mr. **Farmer**. Not among the life or health. They would be operated as separate entities.

Mr. **Guarini**. If the losses are big in health that year, you wouldn't pull from another part of products liability in your portfolio?

Mr. **Farmer**. If you assume you are a multiline company operating through a holding company structure, probably you would want to write more of what seems to be more profitable this year than what is losing lots of money.

Mr. **Guarini**. Then you do do it, or you can do it. You are not prohibited from doing it?

Mr. **Farmer**. No. I think you answered my question. I stated that didn't exist among those entities.

Now, when we talk about casualty insurance, there may be some difference, but when you are talking about life, generally they are operating through a separate subsidiary, completely separate.

Mr. **Guarini**. You keep life separate from casualty.

Mr. **Farmer**. Yes.

Mr. **Guarini**. Within casualty, do you intermingle?

Mr. **Skupa**. Not for ratemaking structure, no, sir. You do it by line, and you do not put in, for example, workers comp into products to make one rate offset another.

Now, again, when the producer is out there selling that and the underwriter is accepting a large risk where there is both workers comp and product and general liability——

Mr. **Guarini**. Is that true of all State laws, or is there a mix?

Mr. **Skupa**. I think all State laws would operate on that basis, that each line has to be kept separately as far as its losses and expense ratio.

Chairman **Pickle**. Gentlemen, thank you very much.

Our first witness is Mr. Maisonpierre.

Mr. **Havens**. I don't see——

Mr. **House**. Mr. Chairman, I don't see him.

Chairman **Pickle**. All right. We have Mr. Havens, LeBoeuf, Lamb, Leiby, & MacRae, Washington, DC, U.S. general counsel to underwriters at Lloyd's, London; and Mr. Harry House, vice president for legislative affairs, Captive Insurance Companies Association.

STATEMENT OF CHARLES W. HAVENS III, PARTNER, LEBEOUF, LAMB, LEIBY, & MACRAE, U.S. GENERAL COUNSEL TO UNDERWRITERS AT LLOYD'S, LONDON

Mr. Havens. Mr. Chairman, my name is Charles Havens. At the risk of being accused of conspiring, I could volunteer to give Mr. Maisonpierre's testimony since one of my previous jobs was his as president of the Reinsurance Association.

However, I will not make that offer, but try to be of as much assistance as I can.

For 25 years I have been a Washington lawyer. I am now partner in the law firm of LeBoeuf, Lamb, Leiby, & MacRae. Our firm is privileged to serve as U.S. general counsel for Underwriters at Lloyd's, London ("Underwriters").

I appear before you today on behalf of Underwriters at the invitation of this committee. My remarks will be very brief; however, I have attached to my statement a copy of the detailed testimony of Mr. Richard Hazell, a member of the council of Lloyd's before the Senate Commerce Committee on March 4.

His remarks speak to the same issues which you are addressing today, and they reflect his 25 years experience as a professional nonmarine underwriter specializing in U.S. business.

I would request respectfully Mr. Hazell's testimony be included in the hearing.

Chairman Pickle. Without objection.

Mr. Havens. Thank you.

Already today you have heard unflattering references to Lloyd's. They might be humorous if they were not so false, misleading, and slanderous to a venerable institution.

I will attempt to set the record straight, however. I have been attempting with Mr. Hazell, to set the record straight since the first congressional hearing on this issue on January 20, but I don't believe that Mr. Nader is reading our testimony.

I should stress at the outset that Lloyd's is not an insurance company. It is an insurance market. Although based in the United Kingdom, Lloyd's is international in every sense of the word.

It is made up of individuals representing 70 nationalities, including the United States, each of whom is subject to unlimited personal liability for the insurance written on his behalf.

The strength of the system is that all underwriters are gathered into a single market where, in addition to competing with one another, they are in competition with other insurers in the United Kingdom and around the world.

Lloyd's has provided quality insurance protection for over 300 years. Underwriters at Lloyd's are deeply committed to continuing their support of the U.S. market, which represents their largest share of the worldwide business.

In 1984, nearly 70 percent of Lloyd's business was in U.S. dollars. Many U.S. accounts have been insured and reinsured continuously for decades.

Every penny of this U.S dollar premium is placed in trust at Citi-Bank in New York in what is called the Lloyd's American Trust Fund.

This trust fund today stands at approximately $6 billion. It is invested almost entirely in U.S. Government or government agency securities, making Lloyd's collectively one of the largest private investors in U.S. Government securities.

It is also collectively the second largest insurance company taxpayer in the United States on the casualty side. Lloyd's loss experience on liability risks in the United States has been horrendous in recent years.

As Mr. Hazell's statement discusses in detail, general liability lines, such as the ones the committee is inquiring about, account for only about 12 percent of Lloyd's total premium income, but in 1982 these liability lines generated virtually 100 percent of their losses.

A more realistic rate structure, that is, one more commensurate with the risk being assumed, is imperative if liability insurance is to be available. Premium increases alone, however, are not a complete solution.

Equally important is the need to enhance predictability in the risks accepted by insurers. Underwriters must be able to close their books and determine profit or loss on account within a reasonable period.

Ultimately, we believe this must be accomplished through use of the claims-made form such as the one proposed by the Insurance Services Office and currently accepted for use in 31 States.

The claims-made form seeks to remove one of the greatest reasons for an insurer becoming insolvent, long-tail liability, which is especially damaging to a reinsurer.

In addition, a claims-made form seeks to match current claims against current income and reduce the difficulty of rating future economic and social developments.

Fortunately, continuity is one of Lloyd's greatest virtues as many insurance buyers in the United States can attest.

Lloyd's takes a long-term view. Underwriters are making every effort to develop terms and conditions of coverage necessary to restore liability insurance to a sound economic footing, both for the insured and the insurer.

How long they can continue to do this depends in part upon the fate of other reforms, in addition to the adoption of the claims-made policy.

The excessive use of punitive damages in the United States has, as you heard from Mr. Civiletti, become the bane of insurers' lives.

I hasten to add that Lloyd's can never play the dominating role in the United States market which has been attributed to it recently.

Although, the underwriting capacity attributed to it has increased every year, and this year by approximately 40 percent, Lloyd's still can write no more than perhaps 2 percent of the U.S. liability business.

Given these figures, I think it easy for the committee to recognize the fallacies of the accusations that have been made against Lloyd's. Lloyd's is not holding the U.S. market for ransom by withholding reinsurance capacity.

I echo Mr. Crosby's request which has been made this morning for the critics of Lloyd's to put up or shut up. They have not colluded with domestic insurers on cancellation of liability coverages.

It is also worth noting that Lloyd's underwriters do not operate here on an unregulated basis. They are accredited reinsurers in virtually every State. They are admitted insurers in Illinois, Kentucky, and the Virgin Islands, and also with a number of Federal agencies with which they file their statements.

In conclusion, Lloyd's commitment to the United States is considerable and long-standing. Underwriters are responding to the extreme losses on U.S. liability risks by working with their traditional buyers to make coverage available.

Underwriters at Lloyd's and my firm stand ready to assist the subcommittee whenever we can.

Thank you.

Chairman PICKLE. Thank you, Mr. Havens.

[The prepared statement follows:]

TESTIMONY OF CHARLES W. HAVENS III, ON BEHALF OF UNDERWRITERS AT LLOYD'S, LONDON

My name is Charles W. Havens III. I am a partner in the law firm of LeBoeuf, Lamb, Leiby & MacRae. Our firm is privileged to serve as U.S. General Counsel for Underwriters at Lloyd's, London ("Underwriters"). I appear before you today on behalf of Underwriters at the invitation of this Committee, which is examining the costs and availability of liability insurance.

My remarks today will be very limited. However, I have attached to my written testimony a copy of the more detailed testimony given by Mr. Richard D. Hazell, a member of the Council of Lloyd's, before the Senate Commerce Committee on March 4, 1986. His remarks speak to the same issues being considered today and they reflect the experience of a professional non-marine Underwriter. I would ask, therefore, that Mr. Hazell's statement be included in its entirety in the record of this hearing.

I should stress at the outset that Lloyd's is not an insurance company, but an insurance market. Although based in the United Kingdom, Lloyd's is international in every sense of the word. It is made up of individuals, representing some 70 nationalities, each of whom is subject to unlimited personal liability for the insurance written on his behalf. The strength of this system is that all Underwriters are gathered into a single market place where, in addition to competing with one another, they are in competition with other insurers both in the United Kingdom and around the world.

There are currently more than 28,500 members, or "Names", at Lloyd's. They include approximately 2,400 U.S. citizens who provide some 10% of Lloyd's underwriting capacity. The members operate in groups known as syndicates, which at present number approximately 400. Each syndicate is managed by a professional underwriting agent, and often deputy underwriters, who are directly responsible to the members in all matters relating to their underwriting business.

Lloyd's has provided quality insurance protection for 300 years. Underwriters are deeply committed to continuing their support of the U.S. insurance market, which represents the largest share of their world-wide business. In 1984, nearly 70% of Lloyd's business was in U.S. dollars, and in the important non-marine lines a very high proportion of that was U.S. situs business. Many U.S. accounts have been insured and reinsured continuously for decades. Moreover, every penny of U.S. dollar premium is placed in trust at Citibank in New York in what is called the Lloyd's American Trust Fund. This trust fund today stands at nearly $6 billion. It is invested almost entirely in U.S. government or government agency securities, making Lloyd's colelctively one of the largest private investors in U.S. government securities.

Lloyd's loss experience on liability risks in the United States has been horrendous in recent years. As Mr. Hazell's statement discusses in some detail, general liability lines account for only 12% of Lloyd's total premium income, but in the 1982 underwriting year, these liability lines generated virtually 100% of Lloyd's losses.

A more realistic rate structure, that is one commensurate with the risks being assumed, is imperative if liability insurance is to be available.

Premium increases alone, however, are not a complete solution to the problem. Equally important is the need to enhance predictability in the risks accepted by insurers. Underwriters must be able to close their books and determine profit or loss on an account within a reasonable period. Ultimately, this must be accomplished through use of the "claims made" policy form, such as the one now proposed by the Insurance Services Office (ISO). The claims-made policy form is intended to remove some of the egregious abuses associated with the current tort system, such as a court's imposition of liability years after coverage is written, where none was intended or paid for. The claims-made policy form seeks to remove one of the greatest reasons for an insurer becoming insolvent: long-tail liability, which can also be especially damaging to a reinsurer. In addition, a claims-made form seeks to match current claims against current premiums and reduce the difficulty of rating future economic and social developments.

Fortunately, continuity is one of Lloyd's greatest virtues, as many insurance buyers in the United States can attest. Lloyd's tends to take a long term view. Underwriters are making every effort to develop terms and conditions of coverage necessary to restore liability insurance to a sound economic footing both for the insured and the insurer.

How long they can continue to do this, however, depends in part on the fate of the other reforms, in addition to the adoption of the claims-made policy form. The excessive use of punitive damages has become the bane of insurers' lives. As Lloyd's Underwriter Richard Hazell told the Senate Commerce Committee:

"[A]lthough as the name suggests intended to punish wrongful actions they [punitive damages] are currently being used as a method of coercing insurers to compromise their position and their policies to save themselves from excessive punitive awards.

"These then together with 'bad faith' actions very often asserted by the insured against his insurers have given rise to the situation where casualty insurers and as a result their reinsurers, are unable to quantify, in monetary terms, the risks they are being asked to run. Being professional and owing a duty to their own investors their duty would seem to point to withdrawing from this class of business in favour of something more predictable."

I hasten to add that Lloyd's can never play the dominating role in the United States which has been attributed to it recently. Even though the underwriting capacity of Lloyd's has increased this year by approximately 40%, in dollar terms, it can still write no more than perhaps 2% of the total U.S. liability business. Given these figures, I think it is easy for this Committee to recognize the fallacies in certain accusations made against Lloyd's, some of which this Committee heard in these hearings. Lloyd's Underwriters most certainly are not holding the U.S. market "for ransom" by withholding reinsurance capacity, nor have they colluded with domestic insurers on cancellation of liability coverages. Were Underwriters to react in this way to their losses on liability business, they would jeopardize some of their most important accounts while alienating many with whom they have long enjoyed close business ties.

It is also worth noting that Lloyd's Underwriters do not operate here in an unregulated fashion, as has been charged. Lloyd's Underwriters are accredited reinsurers throughout the U.S., eligible surplus lines insurers in all jurisdictions, and licensed insurers in Illinois, Kentucky, and the U.S. Virgin Islands. In addition, a number of federal agencies have recognized Lloyd's insurance and reinsurance. Consequently, Lloyd's files each year audited financial statements with the U.S. Treasury Department, many State Insurance Departments, and the National Association of Insurance Commissioners.

Lloyd's commitment to the U.S. is considerable and long standing. Underwriters are responding to the extreme losses of U.S. liability risks by working with their traditional buyers to develop terms of coverage which will continue to make liability insurance available. Underwriters at Lloyd's and our firm stand ready to assist this Subcommittee in whatever manner we can.

STATEMENT BY RICHARD DENNIS HAZELL, MEMBER OF THE COUNCIL OF LLOYD'S, SUBMITTED TO THE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION OF THE U.S. SENATE ON MARCH 4, 1986

My name is Richard Dennis Hazell, I am a Member of the Council of Lloyd's which is an honorary position. I earn my living as an active non-marine underwriter. That is to say, I accept or decline the risks which are shown to me from the United States and elsewhere in the world, on a daily basis. I am here at the invitation of this Committee which, I understand, is examining availability and cost of liability insurance.

My purpose today is to inform this Committee concerning the position of Lloyd's and to do that I should like first to deal briefly with the constitution of Lloyd's. I should stress at the outset that Lloyd's is not an insurance company but an insurance market which is international in every sense of the word. It is made up of individuals representing some 70 nationalities who, with unlimited liability write insurances each for their own account and not one for another. The strength of this system is that all underwriters are gathered into a single marketplace where, in addition to competing one with another they are in competition with insurance companies both at home and abroad. The primary concern of a Lloyd's underwriter is to endeavour, by applying sound underwriting principles, to make a profit on his underwriting business.

There are currently more than 28,500 Members of Lloyd's. They include nearly 2,400 United States citizens who, incidentally, provide some 10 percent of Lloyd's capacity. Members operate in groups known as syndicates which at present number approximately 400. Each syndicate is managed by an underwriting agent who is directly responsible to the Members for whom he acts in respect of all matters relating to the conduct of their underwriting business.

All business placed at Lloyd's must be effected through a Lloyd's broker. There are currently 258 firms of insurance brokers who are qualified to enter the Underwriting Room at Lloyd's for the purpose of placing insurance business with Lloyd's underwriters. Under regulations which have been in force for many years no firm of insurance brokers is admitted into the Underwriting Room at Lloyd's unless it is fitted to undertake the responsibilities which such a status involves. This does not mean that such a firm places insurance for its principals solely with Lloyd's underwriters. These firms can and do use all markets. Indeed, it is their duty to find the market which will provide for their clients the best terms consistent with security and good service. Even within the Lloyd's market the broker well knows that individual underwriters are in competition with one another and if he fails to find the best market there is every likelihood that another broker will improve on the quotation.

Lloyd's has existed for more than three hundred years and currently operates pursuant to an Act of Parliament sought by Lloyd's to strengthen its self-regulatory powers, known as the Lloyd's Act of 1982. (Exhibit "A") which created the Council of Lloyd's as the govrening body of the Society. At the same time it charged the Council with "the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's."

It is against this background that I would like now to say something about Lloyd's imvolvement in the United States which began nearly a century ago. By 1984, the last year for which I have figures, nearly 70% of Lloyd's business was in U.S. dollars and in the important non-marine field a very high proportion of that was U.S. situs business. I make this distinction because all Lloyd's U.S. dollar premiums no matter where in the world they may be earned are held by U.S. Trustees, Citibank here in the United States in what is called Lloyd's American Trust Funds. These funds which today stands at $6 billion are invested almost entirely in U.S. Government or Government Agency issues making Lloyd's collectively one of the largest private investors in such securities.

Thus, the American insurance industry is not exporting billions of dollars to Lloyd's as has been alleged, since very cent of Lloyd's U.S. premium income is retained in this country where it is voluntarily kept and invested. This is true not just for U.S. situs business but for all Lloyd's U.S. dollar business wheresoever it is derived. The only payments which are made from the funds are claims settlements and ascertained profits at the end of each year of account. Also, as alien insurers privileged to do business in this country, Lloyd's underwriters, over a fifteen year period through 1984, paid enough U.S. Income Tax to make them the second largest contributors to the Internal Revenue Service of all U.S. property and casualty insurers.

Moreover, Lloyd's underwriters are accredited reinsurers throughout the United States, eligible excess or surplus line insurers in all jurisdictions as well as being licensed insurers in Illinois, Kentucky and the U.S. Virgin Islands. In addition, a number of Federal Agencies have recognized Lloyd's, as evidenced by the leading role traditionally played by Underwriters in the reinsurance of the Overseas Private Investment Corporation. Consequently, Lloyd's files each year audited financial statements with the U.S. Treasury Department, many State Insurance Departments and the National Association of Insurance Commissioners.

Lloyd's commitment to the United States is, therefore, considerable and the suggestion which has been made in some quarters that we are seeking to pressurize U.S. insurance companies by boycotting their business is manifestly untrue. Indeed, were underwriters at Lloyd's to react in this way to what is, admittedly, a very serious situation they would jeopardize some of their most important accounts while alienating those with whom they have long enjoyed close business and personal ties. The fact is that Lloyd's losses on U.S. general liability business reflect those suffered by American insurers.

Lloyd's leaves its accounts open for three years. This conservative rule enables us to present a more accurate picture of a given year's trading than would be the case were we to draw the line at the end of twelve months. Thus, 1982 is the last year for which complete figures are available (Exhibit "B"). Out of nine statutory accounts eight broke even or made a profit, in some cases a very handsome one. The ninth, the worldwide general liability account, the vast majority of which came from U.S. dollar business, consisted of premium income of £346 million, investment income of £142 million, claims and expenses of £802 million producing a net loss of £314 million.

In other words this one class of business which generated only 12 percent of Lloyd's total premium income was responsible for virtually 100% of our losses. Nor, as I have seen reported, are these results distorted by an adverse sterling/dollar exchange rate. Due to Lloyd's American Trust Fund the only effect a fluctuating rate of exchange can have on our U.S. dollar balances is to increase or decrease, in sterling terms, an ascertained profit or loss as accounted to the Members at the end of three years.

Although these returns relate to 1982 there is every sign that those for the recently closed year 1983 and the open years 1984 and 1985 will be as bad and according to some predictions, even worse. That being so Members of Lloyd's might well ask why underwriters should endanger their accounts by persisting with this class of business when they might profitably do what they have been accused of doing which is to pass by on the other side and leave someone else to solve the problem.

Fortunately, however, continuity is one of Lloyd's virtues, as many insurance and reinsurance buyers of major U.S. companies will confirm having placed business with us for many years. Underwriters are currently making strenuous efforts both to quote terms which they can justify to their Members and which their clients will be able to afford. However, the length of time they can continue to do this must ultimately depend, on a combination of three factors; a rating structure commensurate with the risk, our client's acceptance of the claims made form and the ability to close our books and determine profit or loss within a reasonable period.

The case for a more economic rate structure is, I believe, well made by the figures I have already quoted but I would like, if I may, to give you one or two more. From a book of Municipal Liability business placed in Lloyd's the current incurred loss ratio (that is those losses already paid together with reserves for those outstanding losses still to be paid) over a four year period is an average of 425%. On a book of Directors and Officers liability business which has been placed in the London market the incurred loss ratio has never, at any time over the past five years, bettered 200%. And finally a statistic that you may have heard before, the cost to the insurance industry of asbestosis.

To date some 40,000 cases have been notified and the final bill is being spoken of in billions of dollars. To handle this problem, which is industry wide, the Wellington Committee was set up at Lloyd's instigation and an agreement was signed here in Washington D.C. in June of last year, the first claims being settled three months later. The Committee maintains a central register involving insurers and producers and manufacturers in the asbestos industry and its aim is to speed the flow of money to injured parties. The sad fact is that 66 cents in every dollar paid out in claims goes, not to those who have suffered, but as plaintiff's and defendant's fees and expenses. Imagine the additional costs this places on insurance premiums.

The argument for a "Claims Made" form for insurers is irrefutable, without it we cannot stay in business as it would mean leaving a trail of paper behind us which, many years later, could be presented as total losses, very often as a result of an interpretation being placed upon a policy wording which it was never intended, by either principal, should apply. The position has been created, therefore, where, if the insurance industry cannot be convinced that the wording of their policies will prevail, they must adopt a different course, that being to shorten the period of time between event and interpretation. In this way the intention of the policy will be more easily understood should it be contested in Court. This is being brought about through the introduction of the "Claims Made" form by which the event I spoke of a moment ago becomes the time the claim is made rather than the date of the original occurrence.

The insurance industry is responsible to its shareholders or, in the case of Lloyd's, to its Members and, of course, its policyholders. By moving to a "Claims Made" form it is not, as has been suggested, avoiding its responsibilities but is, I believe, safeguarding the interests of those who provide the security against which risks may be underwritten. While the insuring public will hold policies which protect them against any claim made within the duration of those policies and will have the same protection in the future as each recurring renewal will be written on the same form as that which they already enjoy. The benefits, I am convinced, will accrue to insurers through a greater awareness of their immediate costs and to policyholders through more stable premiums.

As to the question of tort law reform I am neither a lawyer nor an American. Discretion and good manners, therefore, suggest that I should limit my observations to the consequences if the present situation continues. Insurers and reinsurers at Lloyd's have determined that the current lottery they face in writing American Casualty business can no longer be supported. I have chosen the word lottery carefully, as it appears to me that this is what Underwriters have to contend with when presented with a potential claim.

In the first instance there arises the question of location of the trial, will the plaintiff obtain the advantage of a local and sympathetic jury, will the jury be knowledgable enough to fairly evaluate the worth of what is very often extremely involved expert testimony, and then of course there is the question of punitive damages. These have become the bane of insurers' lives and are, in my view, largely responsible for the position the insurance industry finds itself in today. Although as the name suggests intended to punish wrongful actions they are currently being used as a method of coercing insurers to compromise their position and their policies to save themselves from excessive punitive awards.

These then together with "bad faith" actions very often asserted by the insured against his insurers have given rise to the situation where casualty insurers and as a result their reinsurers, are unable to quantify, in monetary terms, the risks they are being asked to run. Being professional and owing a duty to their own investors their duty would seem to point to withdrawing from this class of business in favour of something more predictable.

However, as I have already stated, Lloyd's has an historical commitment to the United States and providing that Underwriters can see some measure of movement toward predictability in the factors I have detailed, a market will always be available at Lloyd's for American business though I should, perhaps, sound a note of caution. Although the capacity of the Lloyd's market has increased this year, in U.S. dollar terms, by approximately 40 percent it can still write no more than 2% of the total liability business generated in the United States. Of course, it is very flattering to read that the buck stops at Lloyd's but, in reality it does not. It stops where it has always done, here in the United States, though not on this occasion in the Oval Office but in the pocket of the consumer.

Chairman PICKLE. Mr. House, if you will proceed.

STATEMENT OF HARRY R. HOUSE, VICE PRESIDENT FOR LEGISLATION, CAPTIVE INSURANCE COMPANIES ASSOCIATION, INC.

Mr. HOUSE. Thank you.

I am Harry R. House, president of the National Telcom Corp., a Vermont captive insurance company sponsored by the National Telephone Cooperative Association, and vice president-legislation of the Captive Insurance Companies Association, commonly referred to as CICA.

CICA is a nonprofit association representing nearly 167 captive insurance companies sponsored by groups, associations, or corporations who are utilizing the captive concept to solve insurance problems for their corporation or industry.

Having spent nearly 30 years in either underwriting or managing captive insurance companies, it is most interesting to see the severity of the current crisis. Never before have I seen the problem relating to such a broad spectrum that includes not only business and industry, but municipalities, director's and officer's liability as well as professional liability.

The significant increase in interest in the captive insurance company as a tool to management to solve their insurance problems now seems to be focused in the association or group area. Since virtually no one is immune from the current insurance crisis, all segments of society are looking for alternatives for solving the problem.

In looking at the causes for the increased interest in captives, let's identify those specific areas of concern.

First, the drastic increases in premiums and restrictions in coverage have realistically affected almost everyone with far-reaching frustration. We haven't always identified the increases, but in some cases they have become critical. Budgets and financial projections, by all elements of business and industry, have created an environment unparalleled in recent memory.

Due to basic restrictions in coverage, the increase in individual retentions of risk by each insured now creates a new problem for business and industry where anticipation of the long-term effect on their financial statements is almost impossible to project. Often, retentions—we might say those retentions are often the amount which is self-insured, which are often required by underwriters—exceed prudent management approval.

Second, the decreased capacity in the marketplace, due to increased premiums, is compounded by the same problem in the reinsurance marketplace.

Having said all of the above, we must also recognize that with the broad-based problem, the captive insurance company arena is affected in at least two major ways.

One, more interest is generated in an attempt to fix the problem, since the commercial carriers generally present no viable alternatives.

Two, reinsurers have less capacity due to increased premium volume, and with the loss history of the past 2 or more years, many reinsurers are withdrawing from several classes of business.

There is one positive element, however, in this area to be considered. Those organizations with available group programs now have the opportunity to generate new capacity through the development and utilization of the captive concept.

Having identified some of the basic areas of concern and the similar effect on the captive arena, where some of the captive insurance companies are faced with the same problem, let's look at some of the fundamental issues involved and the trickle down within the economy.

Underwriting losses in the most recent 3 to 4 years exceed all losses in nearly 20 years. Losses for a single year for a single company have exceeded $1 billion. Almost every insurance company in operation has a fundamental problem of projecting losses for the future. Future values of incurred but not reported losses. Those are losses we don't know but have to account for. This is largely due to the fact that judgments currently rendered by the court are not predictable. Actuaries who are required to make such judgments are more and more frustrated because it is extremely difficult to anticipate the erratic evolution of claims results. In the past, we could generally project results from underwriting based on past experience with some degree of efficiency.

The judicial system must bear some of the concern for the direction we now face.

Cash flow underwriting was a product of the era when interest rates exceeded the norm by such a significant amount that senior executive management of the insurance industry simply abrogated their responsibility to underwrite the business piece-by-piece. The end result—no actual underwriting of any significant amount and profits were derived solely from investment income.

Now, we have lost nearly a decade of underwriting expertise, and cash flow underwriting is gone due to interest rate retraction.

What is the result? Possible over-reaction. Now, we must train underwriters to go back to class underwriting—exclude risks with known large loss history. Develop a loss control program and emphasize the handling of claims to the letter of the contract.

In other words, it is not all the fault of the judicial system. Senior executive management of all insurance companies must take a new interest in the pricing of their product. And they should understand the 5 years of poor underwriting cannot be recouped in 1 or 2 years.

While the captive industry has received fallout from the problems as identified, it is unique in that it is able to react more quickly to changes within its limited area of operations.

The captive community is more in tune with the needs of business, industry, or civil areas of underwriting. They can concentrate on loss and claims control, develop premium payment/dividend plans directly responding to their individual needs. But they are still subject to the serious areas of concern outlined, such as reinsurance, courts, and so forth.

In conclusion, for the future, serious consideration should be given to judgments in our judicial system. Tort reform is needed for the insurance system, as we know it, to survive.

Underwriting of risk should also involve a close scrutiny of loss and claims control.

Industry supervision at the State level needs to be placed on a purely professional basis.

The captive insurance company may be the only clear way to provide an alternative for risk transfer and may be the way to seriously revise the underwriting for the future. Remember that the industry mutuals of the thirties and forties, such as Liberty Mutual, the Lumber Mutuals and Employers of Wausau all provided ways to solve insurance problems in their early days for specific industries.

Thank you very much for this opportunity.

Chairman **Pickle**. I assume you are Mr. Maisonpierre.

Mr. **Maisonpierre**. I apologize for being late, Mr. Chairman.

Chairman **Pickle**. We are glad to have you here. You may proceed and make your statement.

STATEMENT OF ANDRE MAISONPIERRE, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA

Mr. MAISONPIERRE. Thank you.

My name is Andre Maisonpierre. I am the president of the Reinsurance Association of America. Its member companies are principally engaged in the assumption of property and casualty reinsurance and they are either domestic U.S. companies or U.S. branches of foreign reinsurers entered through and licensed by a State. All the companies are regulated by the various States in which they are domiciled or licensed.

Reinsurance is an insurance transaction whereby the reinsurer agrees to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain.

The transaction does not involve the policyholder who looks only to his insurer for defense and indemnity against loss.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry.

In 1984, the premiums collected by U.S. reinsurers amounted to less than 10 percent of the total property and casualty insurance premium.

However, U.S. property and casualty insurers also purchase extensive amounts of reinsurance directly abroad and, for that matter, in order to achieve proper risk spreading, U.S. reinsurers also purchase reinsurance—known as retrocessions—from foreign companies.

Dependence by the U.S. market on foreign reinsurers has diminished from 34.3 percent in 1969 to 27.7 percent in 1984. Since 1969, the net premium assumed by U.S. reinsurers has increased in excess of 600 percent.

Since reinsurers indemnify primary and excess insurers for losses paid under their direct policies, they are impacted by the same legal and legislative developments affecting property and casualty insurers, except that the impact on reinsurers can be compounded.

For instance, reinsurance contracts written in the 1950's and 1960's for relatively low premiums are today responding pursuant to court decisions, retroactive legislation and jury awards to claims never anticipated when these contracts were issued.

These unexpected liabilities have demonstrated to reinsurers the unpredictable nature of some casualty risks and the liabilities which they create.

Further, they have reduced the industry's available assets. You may wonder why these ancient contracts are responding to claims being filed currently.

The reason is that the traditional general liability insurance policy provides for coverage of any loss arising from an occurrence which can be traced to the time the policy was in force irrespective of when the loss is reported.

Although this delay creates serious problems for all insurers, there is a marked difference in loss development patterns as between reinsurers and primary insurers.

For instance, in workmen's compensation, a primary insurer is aware of 75 percent of the losses it will incur on the first anniversary date of the policy. The reinsurer only knows 15 percent of its losses by that time.

After the fourth year the primary company knows of all but five percent of the loss it will incur. The reinsurer is still unaware of 60 percent of its liabilities.

In the general liability area, a reinsurer will continue to be ignorant of large amounts of losses to be generated on contracts it enters into in 1986 by the end of the century.

These losses, nevertheless, will be adjudicated in the social, judicial, and economic environment which will then prevail. Yet, the premium to be paid for those losses must be collected in 1986.

The reinsurance industry has incurred growing losses over the past several years. As a result, its equity or surplus has been reduced, and its ability to provide a market has been constricted.

However, it should be noted that preliminary data for year end 1985 shows that the 15 largest U.S. reinsurers increased their premium writings that year by more than 40 percent.

They also generated a surplus increase slightly less than 30 percent, most of which was generated through surplus infusion provided from outside sources, not from operating profits generated from within the insurance industry.

Our statement details some of the changes which have taken place in our civil justice system as well as our tort laws in the recent past and how these are adversely affecting reinsurers.

The only conclusion which we can draw from these observations is that some commercial casualty lines of insurance are becoming so unpredictable in the losses which they generate over time as to be uninsurable.

A degree of predictability is essential to insurance and reinsurance pricing, and until the civil justice system is restructured the availability of reinsurance in some critical lines will remain illusive.

We are encouraged by the level of attention which problems associated with our tort system is generating at both the State and the Federal levels; however, we are disappointed with the level of legislative actions to date.

We believe that a fair balance between the interest of all parties can be achieved. In fact, unless such a balance is structured, the insurance and reinsurance problems which have been brought to your attention by your constituents will persist and, in fact, are likely to grow worse.

Thank you very much, sir.

Chairman PICKLE. Thank you, Mr. Maisonpierre.

[The prepared statement follows:]

STATEMENT OF ANDRE MAISONPIERRE, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA

My name is Andre Maisonpierre, President of the Reinsurance Association of America, a trade association of professional reinsurers. Our member companies are professional reinsurers principally engaged in the business of assuming property and casualty (p/c) reinsurance and are either domestic U.S. companies or U.S. branches of foreign reinsurers entered through and licensed by a state. All the companies are subject to the regulatory jurisdiction of the various states in which they are domiciled or licensed.

We appreciate the opportunity to address the dual issue of availability and affordability of reinsurance.

Reinsurance is essentially an insurance transaction whereby the reinsurer, for a premium, agress to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain under its policies of insurance. It provides reimbursement to the ceding insurers for losses which they sustain. Thus, it is a transaction which does not involve the policyholder who looks only to his insurer for defense and indemnity against loss. It is often described as the insurance of insurance companies because it provides reimbursement for the insurer's losses under policies covered by the reinsurance contract. Reinsurance is purchased by the primary or excess ceding insurer for its own benefit so that it can spread its risks and limit its own liability from large or catastrophic losses.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry.

Reinsurance contracts are shaped to meet the specific needs of the ceding insurer. Despite the fact that there are no standard reinsurance contracts, there are two basic types which are used and adapted to accommodate the buyer's business. A reinsurance *treaty* is a broad and often automatic agreement that covers some portion of a particular class or classes of business, i.e., the ceding insurer's entire workers' compensation or property book of business. In contrast, a *facultative* agreement covers a specific risk of the ceding insurer and requires the insurer and reinsurer to agree on terms and conditions on a contract-by-contract basis. Both treaties and facultative agreements may be based on a *pro-rata* distribution where the two parties share proportionately in premiums and losses. The agreements may also be written on an *excess* basis, where only the losses of the insurer in excess of a predetermined amount, known as the "retention," are reinsured. It must also be noted that many reinsurers also provide *direct* excess insurance to policyholders, although this direct business generally represents a small portion of a professional reinsurer's entire book of business.

The 1984 U.S. property and casualty reinsurance market received approximately $11.3 billion in gross premium. Of this amount, $10.9 billion was for reinsurance assumed and $445 million for direct excess insurance. This represented less than *10 percent* of the total net premium written by all property and casualty companies.

Further, many U.S. insurers purchase their reinsurance directly abroad. The U.S. Department of Commerce estimates that in 1984, in excess of $3 billion in net premium was paid to unlicensed foreign reinsurers. Another important factor to recognize in analyzing reinsurance premium distribution is that U.S. reinsurers, in order to achieve the needed risk spreading, must turn to the international reinsurance market just as the latter cedes some of its exposure to U.S. reinsurers. Although data recording these transactions are not collected systematically, indications are that foreign reinsurers assume a significantly larger portion of U.S. risks and, indeed, U.S. insurers paid $1.3 billion more in reinsurance abroad in 1984 than were received by U.S. reinsurers from ceding foreign companies.

The domestic reinsurance market has undergone rapid growth over the past 15 years. Since 1969, there has been better than a 6.6 fold increase in the net premium assumed by U.S. reinsurers. The dependence on foreign companies also has grown but their penetration of the U.S. market has been reduced from 34.3 percent in 1969 to 27.7 percent in 1984.

It should be observed that the extent of utilization of reinsurance varies considerably from primary company to primary company. A study[1] recently published by Conning and Co., an investment firm which conducts extensive financial analyses of the insurance industry, notes that among 26 primary underwriters studied, utilization varied in 1984 from a high of 46 percent of gross premium to a low of less than 1 percent. The average utilization rate for the 26 companies was 16.9 percent in 1984, an increase from 10.7 percent in 1975 for these same companies. Further, it is clear that those companies which tend to underwrite large or hazardous commercial risks are more depended on reinsurance despite their higher retention levels.

For reasons I will describe in a moment the reinsurance industry today absorbs a disproportionate percentage of total insurance losses. The Conning Report observes that "for all the companies and during the ten years in this study, 116.4% of the cost of reinsurance was returned to the primary companies in the form of paid losses reimbursed or reinsured losses still collectible. *1984 was a disaster for reinsur-*

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[1] Reinsurance Use and Cost of Reinsurance versus Benefit—A Comparison of Primary Property and Casualty Insurers, Conning & Co. (December 1985)

ers, with the above ratio deteriorating from 121 percent in 1983 to 173 percent in 1984." (Emphasis added.)[2]

Since reinsurers indemnify primary and excess insurers for losses paid under their direct policies, they are impacted by the same legal and legislative developments affecting property and casualty insurers. Any factors increasing the frequency or the amount of losses will increase the reinsurer's liability, although the effect on reinsurers can be even more dramatic than on direct writers.

The insurance industry's enormous and still expanding liability in the casualty area under general liability policies issued in the past has had and will continue to have a major influence on the present and future ability and inclination of reinsurers to continue to expose their capital and surplus in these same lines of insurance, until and unless major reforms in both the policy forms and the civil justice system take place. Experience on current and past policies is creating current and future liabilities of such unanticipated magnitude and unpredictable nature that the reinsurance industry finds it almost impossible to assess its present total responsibility.

Insurance policies and reinsurance contracts written in the 1950's and 1960's for relatively low premiums are now responding pursuant to court decisions or retroactive legislation to claims which were never anticipated under the contracts. The resulting impact on reinsurance has been traumatic.

First, these unexpected liabilities as well as other losses are draining the industry's policyholders' surplus and hence its ability to provide the capacity needed in all lines of reinsurance. Second, these losses have highlighted the totally unpredictable nature of casualty risks and the liabilities which they create and how these, in turn, can be enlarged by the courts and by legislators. Taken together, these forces are likely to discourage the reinsurance industry from writing risks it cannot understand, rate or limit with any certainty. Instead, it will likely commit most of its available capacity to product lines providing some profit potential. As a matter of fact, a reinsurer will need to adopt this behavior if it wants to remain solvent. It must do so for the benefit of all of its client companies and its shareholders.

As previously mentioned, the reinsurance industry is today absorbing losses from primary insurers disproportionate to the amount of premiums received. This is a relatively recent development. The ratios of loss and loss adjustment expenses to premiums for reinsurers and insurers were quite similar from 1980 to 1982. However, in 1983 the reinsurers' ratio exceeded primary insurers by 4 percent and 1984 by 15 percent:

	Reinsurers	Insurers
	(Percent)	(Percent)
1980	75	75
1981	76	77
1982	80	80
1983	85	81
1984	103	88

This, as well as the Conning Report, supports the contention that changes in the civil justice environment and the interpretation by the courts of insurance contracts in ways never anticipated by the insurance industry have had considerably worse impact on reinsurers than on the primary companies. Note, for instance, that in the early 1960's, it was common for a reinsured company to offer $5 million or $10 million coverage limits to a policyholder but retain only $50,000 or $100,000, respectively. All losses in excess of those retentions were then intended to be absorbed by reinsurers. However, since it was expected that the reinsureds retention would suffice to cover the majority of losses, the reinsurance premium paid was relatively small.

What has, in fact, happened is that those contract retention limits today are being reached and pierced with unexpected frequency in just about all lines of business as a direct consequence of the unexpected changes in the civil justice system. The result is that reinsurers' past and future liabilities on these contracts far exceed the premium received, plus all the investment income earned on the premium.

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[2] A ratio above 100 percent indicates that reinsurers reimbursed primary companies for losses in excess of premium collected. Note that the study ignores the effect of investment income which, though important, could never offset the losses incurred by reinsurers, in 1983 and 1984.

You may wonder why these ancient contracts are responding to claims being filed currently. The reason is that the traditional general liability insurance contract leaves the insurer exposed to claims filed many years after the insurance policy has expired since the contract provides for coverage of any loss occurring during the policy period irrespective of when the loss is reported. Certain exposures, particularly in the toxic tort area, are particularly susceptible to this latency factor which is generally referred to as the "long tail."

Although this delay in reporting creates serious problems for all insurers, there is a marked difference in loss development patterns between reinsurers and primary insurers. The major reason for these differences lies in the retention feature of excess of loss reinsurance. Since many claims are not valued at ultimate cost initially, the primary insurer may not report such claims to his reinsurer until considerable time has passed because the initial reserve is within the primary insurer's retention. The relative development is much larger for the reinsurer than the primary insurer since the primary insurer's net loss on any particular claim is limited for annual statement purposes to its retention. In addition, the primary company claim department has more direct control over the administration and adjudication of each claim. For instance, in workers' compensation, a primary insurer is aware of 75% of the losses it will incur at the end of the first year of the insurance policy. The reinsurer only knows of 15 percent of its losses by that time. After the fourth year, the primary company knows of all but 5 percent of the losses it will incur; the reinsurer, still does not know 60 percent of its liability.

(Percentage of ultimate losses)

	1st year		4th year	
	Reinsurer	Primary	Reinsurer	Primary
Automobile liability	35	80	80	100
General liability (incl. asbestos)	3	50	20	85
Medical malpractice	2	45	20	90
Workers' compensation	15	75	40	95

Source: 1984 Best's Casualty Loss Reserve Development (for Primary only).

This delay creates major problems for reinsurers in the anticipation of losses, and the consequent rating of future business on the basis of accurate loss information. For the past several years, we have been conducting studies in reinsurance loss development trends. In recent years, loss development factors have become larger. With few exceptions, each year's additional information has proved previous loss development patterns to have been optimistic.

It is no accident that the lines of insurance which are the slowest to develop—the long tail lines—are the ones creating the worst problems for reinsurers. For instance, in the general liability area—even excluding identifiable asbestos losses—by the end of the first year we know little more than 5 percent of ultimate losses, 30 percent by the end of the third year and by the eighth year only 60 percent. It is not until the thirteenth year that we know of 75 percent of the losses that will arise and we slowly hear of the remainder of the losses over the next two decades.

Assuming no change in the future loss development pattern, only a bare majority of losses on reinsurance contracts covering general liability exposures issued in 1986 will be known to the reinsurers by 1994; and, by the end of the century, there will still be large amounts of losses not known by the companies. Note that these losses will be adjudicated in the social, judicial and economic environment which will then prevail, but the premiums to pay those losses must nevertheless all be collected in 1986.

Is it any wonder then, that the reinsurance industry's underwriting experience over the past several years, has gone from bad to atrocious? The industry's combined ratio has shown a worsening in each of the past five years, culminating in an unbelievable 133% in 1984. In other words, reinsurers paid out $133 for every $100 in premium collected on losses, losses incurred, adjustment expenses, administration and commissions. No investment income, no matter what the interest rates may have been, could ever offset such losses.

U.S. reinsurance combined ratio

Year:	
1984	133
1983	119
1982	114
1981	108
1980	107

A.M. Best—1984 Reinsurance Results.

This is particularly disturbing since, as a direct consequence, the reinsurance industry sustained a 7 percent decline in policyholder's surplus despite a large infusion of new capital in the industry. A.M. Best notes that "the reinsurers posted a negative 14 percent return on surplus" in 1984, as compared to a 3 percent negative return for the total property/casualty industry. Best further notes that today, the ratio of Net Liabilities to Surplus for the reinsurance industry exceeds that of the industry average.

What this all means, of course, is that the U.S. reinsurance industry's capacity has diminished substantially at a time when the need for our growing economy for insurance has increased. This capacity is lagging fully behind the expending needs for reinsurance. To reflect the level of solidity and solvency evidenced in 1982, reinsurers' surplus should have increased by 20 percent, not decreased by $30 million over the two year span ending December 1984. It should be noted that the decrease in capacity of the U.S. reinsurance industry coincides with a review of the continued participation in the U.S. insurance and reinsurance markets by Lloyd's and other alien companies.

It has been claimed by some observers that the current insurance-reinsurance market crisis is of the industry's own making. The inadequate rates charged in the past several years, as reflected by worsening underwriting ratios, are said to be indicators of "cut throat" or excessive competition.

No doubt, there was some excess, primarily led by new entrants into the insurance business who did not have sufficient knowledge to judge the consequences of excessively relying on investment income. But, what is often overlooked, is that insurance premiums had to reflect the extraordinary returns the industry was earning on its investments when interest rates were running 15 percent of 20 percent or even higher. Consider, for an instant, what your reaction would have been if insurers had not reduced premium in recognition of their investment returns and had reported unconscionably high profits.

The property and casualty insurance business is undoubtedly the most competitive of any business its size. No single company has enough penetration of any market to act as a price leader contrary to almost any other large commercial or industrial sector of the economy. It is probably this competitive environment which accounts for the industry's failure to have reacted promptly enough to the developing changes which took place recently in the civil justice system. As a result, the underwriting loss expectations have turned out much worse than anticipated.

You have already received extensive testimony on what has occurred to our tort system. No single index tells the tale and there, no doubt, additional measurments which will come to light in the coming months to add to our knowledge. The evidence is clear, however, that present information demonstrates that the system cannot survive for long in its current structure.

Specifically, note the following: [3]

Civil Lawsuits—In 1984, there was one private civil lawsuit pending for every 15 Americans. There were 206,000 civil suits filed in the Federal Courts, an increase of almost 600 percent since 1940. By the end of 1985, new civil case filings were running at twice the level that prevailed in 1979.

Simultaneously, in 1984, there had been filed in our state courts approximately 12 million civil suits.

Product liability cases commenced in Federal district courts have grown from 6,132 in 1979 to 13,554 in 1985.

Lawsuits against public officials have increased by 50% over the last 3 years. Today, 28 percent of all local governments have some lawsuits pending against them as compared to 14 percent in a 1982 survery.

Jury Verdicts—Plaintiffs today are winning a growing percentage of verdicts—47 percent in 1960; 60 percent in the late 1970's. The average size of verdicts has also increased significantly. During the 1970's, awards doubled in size. For products liability, the average annual size of jury verdicts increased from $237,462 in 1973 to $1,246,646 in 1984, a 525-percent increase. The medical malpractice average annual jury verdict grew from $166,165 in 1974 to an estimated $954,858 in 1984, a 575-percent increase.

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[3] See *Crisis in Liability Insurance—A Time for Change*, Conning & Co. (November 1985)

Please note that all claims which are settled prior to verdict are affected by these jury verdicts since claim settlements are based on the expectations of jury awards.

If judgments in excess of $1,000,000 are excluded from the above numbers, the changes in the average cost of products and malpractice claims have been quite reasonable, approximately a 15-percent increase between 1978 and 1983. However, since 1975, there has been a 1,300-percent increase in the number of verdicts over $1,000,000.

Punitive Damages—The Rand's Institute of Civil Justice report on punitive damages demonstrates alarming trends in the two jurisdictions studied. The median punitive damages awards grew 600% from the early 1960's to the 1980–84 period in San Francisco (from $15,000 to $90,000) and 144 percent in Chicago's Cook County (from $9,000 in the early 1960's to $13,000 in 1980–84). The average punitive damages award also increased at a precipitous rate—in San Francisco 734 percent (from $65,000 to $477,000 in the above period and 549 percent for the same period in Cook County, from $98,000 to $538,000).

Although it is evident from the disparity in the average and median verdicts between Cook County and San Francisco that it may be inappropriate to generalize from this study, the available evidence would certainly justify major concern, at least in those jurisdictions, where multimillion dollar punitive awards have been reported.

Rising Cost of Defense—Defense costs incurred by property and casualty insurers have increased 79 percent between 1978 and 1983 during which year $4.2 billion was expended in this category. Of this amount, $1.9 billion was accounted for in the general liability area. In 1983, loss adjustment expenses grew to 41 percent of indemnity losses in the general liability area and some industry observers fear that future defense costs will approximate 50 percent of indemnity payments.

Changes in Tort Law—In addition to increased litigation and increased tort awards and settlements, there has occurred within the past few years dramatic changes in tort and insurance contract laws which have made prediction of future loss trends impossible. Consider, for instance:

The progression of a fault based system to strict liability to, more recently, in some jurisdictions almost absolute liability.

The elimination of comparative and contributory negligence defenses in strict liability cases.

The imposition of liability based on novel enterprise liability theories such as "concert of action," "market share."

Joint and several liability concept which allows recovery from any one of several defendants of the entire award, no matter the degree of negligence among the defendants. This has even been extended under federal law (Superfund) to apply when the defendant is an innocent, non-negligent participant in a lawful act. This results in major inconsistencies where an innocent or marginally negligent defendant who carries high insurance protection end up picking up the lion share of verdicts.

Judicial rejections of insurance contract exclusions.

The expansion of the "duty to defense" insurance contract provision and the imposition of punitive damages awards for "bad faith."

Continued Increases in Incurred Losses—Losses are determined by a combination of claims frequency and severity. The numbers recited above unfortunately clearly demonstrate that there is no let up in the current frequency and severity claim explosions. In fact, the latest available information shows that incurred losses are continuing to increase at a faster rate than premium increases (in 1984, premiums increased 9 percent while losses rose nearly 18 percent). What this means, of course, is that current premiums are still likely to be inadequate to pay losses which will be incurred on newly issued policies and further increases will need to be imposed on policyholders.

What about the future? Availability of an adequate reinsurance market depends on two factors:

1. The ability of the U.S. reinsurance industry to build up an adequate policyholder surplus base to sustain growth.
2. A change in the civil justice environment in which reinsurers must operate which will allow a return to profitability.

Surplus growth can come from two sources. One, is the funneling of outside capital into the reinsurance industry. The well established companies have been successful in the past several months in attracting new capital either through an infusion of capital funds from a parent or through the floating of stock issues. This certainly demonstrates faith in the ability of the reinsurance industry to come out of its slump and return to a profitable state. Not all reinsurers have been that fortunate, however, and some have served notice of intention to either quit writing reinsurance altogether or to limit their diminished capacity to the more certain lines of reinsurance.

The other source of growth is operating profits. As noted above, this avenue will improve if and when the tort system is revamped since those reinsurers with adequate capacity will funnel their resources in those lines which provide a certain degree of predictability. Predictability is essential to insurance pricing and it should be noted will be substantially enhanced once the new CGL contract forms developed by the Insurance Services Office are adopted. The RAA has supported the introduction of the new form since it will create, at least temporarily, some stability in the insurance market.

Ultimately, the availability of reinsurance in critical product lines, at affordable rates, will depend on the restructuring of our civil justice system. We are heartened by the level of interest shown by both state and federal governments on the issue. However, we are not encouraged by the action which the various legislatures have taken to date to reform the tort mechanism. The issue has become overly politicized. It is, nevertheless, essential that the current system be revamped. We believe that a fair balance can be accomplished whereby adequate benefits are provided and manufacturers and others are fairly treated. Until such a balance is restored, the insurance and reinsurance problems which have been identified by your constituents and which have been described in testimony before this Committee are bound to persist.

Chairman PICKLE. I think it is timely I hold up this magazine for you. There Has Been some question today about how serious is this, and we have had some testimony this morning we ought not to fix anything; it wasn't broke, and mostly this insurance problem is not really serious.

I hold up here a copy of today's issue of Time magazine, one of the Nation's outstanding news publications. The headline on it is, "Sorry, America, Your Insurance Has Been Cancelled."

This type of message now is appearing in other publications and it is probably the most debated problem we have in America today.

I don't think we need to try to play games with each other, not this panel or anybody concerned with this problem, because the problem is there. We must try, through this hearing and others, to work to find some kind of answer to it.

Now, Mr. "Lloyd's of London" Mr. Havens, Mr. Nader testified early this morning that you are not insuring a lot of these risks and that you are the pacesetter.

You implied a second ago you don't insure but about 10 percent of the reinsurance market for the United States.

Can you tell me what types of businesses you do not insure now? What has Lloyd's of London stopped insuring?

Mr. HAVENS. Mr. Chairman, you flatter me with the reference to Mr. Lloyds, but I am privileged to represent them.

One of the points that is most apparent to me in responding to your question is how fast moving the scene is at this very moment.

When we first testified on January 20 before another House subcommittee, there were a number of areas identified as being a particular problem in particular States. Day care centers were, in fact, one of those instances.

Since then, maybe not in every State, but in a great many States, the State Commissioners, cooperating with industry, have acted to respond and fill the need.

So, if I stood before you today and said that there was any one particular line that Lloyd's might not be writing, I stand a good chance of being in error within hours of speaking.

I can say that there are a number of lines that possess particularly difficult problems, and the pollution field is certainly foremost on that list.

The general liability business in the United States would also be a troublesome line, but there Lloyd's has not withdrawn, they are looking a lot harder at these risks before they decide to write them.

Municipal liability—and I believe you will hear more from witnesses this afternoon—is another area where, in fact, there may be instances where some of the syndicates at Lloyd's have, in fact, withdrawn.

Chairman PICKLE. Well, since you decline now to list any type of insurance that you will not cover, other than, generally, environmental pollution matters, I would ask that you submit to our committee a statement, Mr. Havens, more specifically outlining the types of insurance that you have, over a period of the last 6 months to a year, been declining to issue.

I recognize that may change on a volatile basis, but give us some idea of the type of thing that you are not insuring, because this is happening.

[The information was not submitted.]

Chairman PICKLE. Now, Mr. House, what types of businesses are actually creating captive insurance companies now?

Mr. HOUSE. Mr. Chairman, right now there appears to be more groups than the individual corporate entities.

For example, you mentioned pollution. There are a number of people that are involved in the chemical industry that have found themselves without any coverage, so they are attempting to work together with themselves to come up with something that will provide excess limits above what they are able to buy or to develop their own pools.

And beyond that, it has to do with those people who manufacture products and sell to the public, people who are manufacturing equipment for the homeowner to use around their home—you name it—commercial entities that sell to resorts and hotels where they have exposures to significant loss in that area.

They are working on putting captives together. There is more of an interest than ever before.

I think, in the State of Vermont under their new captive law a year ago, they had 13 captives. They have 34 today.

Chairman PICKLE. I would like for you to submit to this committee a general statement about the type of businesses that are now creating their own insurance by setting up captive insurance companies.

I think that would be most helpful to the committee.

[The information follows:]

Recent analysis indicates that the entities specifically interested in developing their own captive insurance company to assist them with the insurance crisis involves:

Manufacturers with product liability insurance problems;

Cities, townships, municipalities and counties who have lost or cannot afford general liability insurance from the regular markets;

Manufacturers, suppliers, retailers and distributors of chemical products;

Condo and apartment owners associations with severe problems in securing general liability insurance;

Resort owners/operators utilizing electrical mechanic equipment for operations in addition to other operations subject to severe loss exposures; and

Beach front owners of multiple housing units or property other than wind/fire resistive construction.

Mr. **Havens**. Mr. Chairman?

Chairman **Pickle**. Yes.

Mr. **Havens**. Could I respond, in part, before supplying, as we are very happy to do, additional information to the record?

In the interest of time I omitted from my statement some of the organizational facts of Lloyd's; for example, that Lloyd's is 28,500 individuals doing business in 400 separate syndicates that compete with each other.

Lloyd's has prided itself in making a market for difficult risks, and so it is difficult for anyone to bind his competitors as to what will or won't be written.

Chairman **Pickle**. I noticed in your statement you pointed out that you weren't just an industry. You are more in the market business and consist of a lot of individual groups.

Your entire statement will be made part of the record, so that will be made clear.

Mr. **Havens**. Thank you.

Chairman **Pickle**. Let me ask one other question.

Should States insure for their own losses? Should municipal governments insure for their own losses?

Mr. **Maisonpierre**. Are you asking any member of the panel, Mr. Chairman?

Chairman **Pickle**. I am just asking any one of you. You volunteered, so we will let you respond.

Mr. **Maisonpierre**. I think that the problem with municipal liability is one which is not so much one of an insurance problem, but it is a problem of the environment in which municipalities operate.

There are two issues involved. One is a question of availability of insurance, and the other one is a question of affordability.

Aside from the environmental pollution problem, the biggest problem which I believe municipalities have has to do with the judicial concept of joint and several liabilities.

Now, in those jurisdictions, at least most jurisdictions in which municipalities have had problems getting insurance, States have organized through the State insurance departments what is called market assistant programs.

Unfortunately, it could very well be that the cost of insurance to a municipality, when it is available, may be excessive insofar as the State might perceive, or insofar as the municipality might perceive.

If a State believes the cost of insurance is excessive, and it is prepared to subsidize the cost of insurance so as to make the insurance more both available as well as affordable, then it should probably insure municipalities.

If, on the other hand, States believe that the cost should be that which the losses will determine, then the fact that the State may be providing insurance to the municipalities will not provide a more affordable insurance system.

So, it is a matter of public policy. Does the State want to subsidize the cost of insurance to the municipalities, or does the State want to try to seek ways to alleviate that cost by removing some of the more onerous problems which the municipalities have.

Chairman **Pickle**. Thank you.

Mr. Anthony?

Mr. **Anthony**. Thank you, Mr. Chairman.

Mr. Havens, in your testimony, you say that the Lloyd's marketing group has increased its capacity by 40 percent, yet you assert that you can still only write less than an additional two percent of the U.S. liability market.

Could you explain what happens that creates that type of ratio?

Mr. **Havens**. I will be happy to try, Mr. Anthony.

The Lloyd's market is basically reported in nine separate accounts such as motor vehicle, marine and nonmarine market general liability.

A certain amount of that capacity would be dedicated to these other lines. The fact is that in the United States the primary insurance markets write most of that general liability line.

As other witnesses have told other subcommittees this year, it is surprising when one looks at it as to how small the actual reinsurance capacity is.

The reinsurance capacity is, basically, if you look only at the U.S. companies, ten percent of the primary industry. When you add Lloyd's to that, you don't increase that ratio very much.

Mr. **Anthony**. I guess that is what is perplexing. Other witnesses come in and they say the tort system is not broke but the reinsurance market is shrinking. As a result of that contraction, insurers are having difficulty getting reinsurance.

As a result, insurers have to absorb more of the risk, and in order for them to justify that, they have to jack the rates way up and cut coverage.

Yet you come in and say that the reinsurance market is so small in terms of net total premiums. I must admit you have educated me on how big Lloyd's is, even in the United States. Help me sort through their arguments about the role of insurance and your statements.

Mr. **Havens**. I will start and will be happy to defer to other members of the panel.

Back in the days of the "loose market," as it has been called, when interest rates were high, a number of primary insurers and others thought it was a good time to get into the reinsurance market. And they came in droves, because you don't have to be a "reinsurer" to reinsure.

Any primary insurer can, with its certificate of authority, automatically reinsure any line, and it can write directly. That situation has radically reversed itself in the last 2 years with over 90 so-called U.S. underwriters of reinsurance withdrawing or severely curtailing their reinsurance operations, and something like another 20 just dropping out of business entirely.

The reinsurance market has contracted. It really is the law of large numbers. It is interesting that the reinsurers in the United States can still attract capital as one entity.

One reinsurer has attracted over $600 million within the last year of new capital, and yet that $600 million, when compared with the $100 billion primary industry, doesn't or can't make up a whole lot.

If the risk isn't written properly at the primary level, it can't be reinsured. Reinsurance can't cure bad underwriting. It can only help to spread the risk of loss among a broader number of companies.

Mr. ANTHONY. So, there is a contraction in the number of companies that are actually writing reinsurance.

Mr. HAVENS. That is correct.

Mr. ANTHONY. Does that parallel the numbers of dollars that are being reinsured or is this——

Mr. HAVENS. I can't testify to how much is offset by the new capital that is being attracted, but certainly not enough is being attracted to make up for the losses, and there is no question but that companies have even become insolvent, as you heard from prior witnesses.

Mr. ANTHONY. Mr. Maisonpierre?

Mr. MAISONPIERRE. Mr. Anthony, we have just completed a study of the 15 largest reinsurers in the United States for their 1985 reinsurance operations. Those companies increased their premium writing in excess of 40 percent over 1984.

Simultaneously, their surplus or their equity for those 15 companies also increased a little less than 30 percent in 1984, from 1985 over 1984.

Now, these companies, these 15 companies, comprise approximately 40 percent of the reinsurance market. We will not have the final tabulation of the entire 1985 premium writings and surplus of the U.S. insurance industry for another 2 or 3 months. Yes, there have been some withdrawals in 1983 and 1984 and 1985 from the reinsurance arena.

The companies that have withdrawn, except for two, are relatively small companies and I would suspect that with the infusion of new capital into the reinsurance business in 1985, a little less than 30 percent just for those 15 companies, that we will see an increase in the surplus or equity of the domestic reinsurance business in 1985 as compared to 1984.

I should also point out that to the extent those 15 companies wrote in excess of 40 percent additional premium and only acquired 30 percent in additional surplus, the solidity of those 15 companies is perhaps weaker than it was in 1984 because you had as a percentage base less of a surplus to premium relationship in 1985 than you had in 1984.

You increase your premium by 40 percent while simultaneously you increase your surplus by 30 percent, you are not quite in as strong a position. But I do believe the infusion of an additional 30-percent additional capital into those 15 companies is a very healthy sign.

In 1984, as compared to 1983, there was a 7-percent decrease in the amount of capital surplus available to the domestic reinsurance industry. So I think that 1985 was a good sign and I believe that 1986 will be a better year because the underwriting ratios of the reinsurance industry, which was literally horrendous in 1984—for every $100 collected in insurance, they spent $133—in 1985, we believe that ratio, when we have the entire picture for the industry, will be between 118 and 120, meaning that for every $100 collected in premium, they will generate between $118 to $120 on in losses—this is a major improvement. Yet, it still is pretty bad. Five years ago, a reinsurer saying that 120-percent combined ratio was an acceptable ratio would have been shot right there and then, but it is a major improvement over 1984 and at least it is a sign in the right direction.

Mr. ANTHONY. I don't know if any of you heard the Texas State Insurance Commissioner's testimony or if you had an opportunity to read it. He did give us a horror story about a primary policy, then a pattern of reinsurance, reinsurance, reinsurance, reinsurance, reinsurance, reinsurance. Then there was a claim, but as they go through the paper trail, the reinsurance just conveniently disappears in some foreign country.

This is a problem. Is this something we should be cognizant of or is this just an unusual occurrence where you had some just absolute thieves in the market?

Mr. Maisonpierre first and then Mr. Havens.

Mr. MAISONPIERRE. I would know, Mr. Anthony, whether these are thieves. I wouldn't qualify that, but I think it is something to be concerned about and the National Association of Insurance Commissioners have taken some fairly strong action.

It has developed what is called a model credit for reinsurance model and we have supported this and so has Lloyds. What that provides is that for a primary company to be able to take credit on its annual statement for ceeded insurance—and this is an important consideration for primary companies to be able to do—the reinsurance must either be with a company which is licensed in a State which has standards of solvency similar to or higher than those in existence in the State of domicile of the primary company or it must be reinsured in a company which has a dedicated trust fund in the United States in a U.S. bank or must have letters of credit issued by a bank which is a member of the Federal Reserve system or must have some form of other security such as cash acceptable to the insurance commissioner.

This way a domestic primary insurance company reinsured with the X, Y, Z insurance company in Malay, just to name a country, will have some backing to its reinsurance. We have supported this.

We have spent a good deal of our time the last 2 years as an association going from State to State and we have received very, very good results legislatively in getting this legislation enacted.

I would be delighted to make available to the committee the present status of this type of legislation or law in the different States.

Mr. ANTHONY. I wish you would. I think it would be beneficial to our hearings.

[The information follows:]

In the full legislative year (1985) following adoption by the NAIC of the model bill, the following states adopted the model: Delaware, Tennessee, Nebraska, and North Carolina.

In 1986, the model is expected to become law in: Utah, New Hampshire, and Kentucky.

Also, legislation or regulation similar to the model is anticipated to be adopted in 1986 in: Vermont and Virginia.

Finally, many states today already enforce stronger laws over and above the NAIC model. Hence, no changes are required in those states. Among these states are: Iowa, Texas, Arizona, Colorado, Illinois, Kansas, Michigan, Mississippi, and Ohio.

Mr. ANTHONY. Mr. Havens.

Mr. HAVENS. Very briefly to supplement what Mr. Maisonpierre has said, there is one factor as important as the ability to get insurance and that is the ability to collect on it. The same is true of reinsurance.

Lloyds already qualifies under the existing standards for collectibility in the United States and credit for reinsurance and supports and has supported the new model credit for reinsurance bill under which it would also continue to qualify.

Mr. ANTHONY. Thank you. Mr. House.

Mr. HOUSE. Just to give you gentlemen on the committee an understanding of how important it is what these gentlemen have talked about is those of us who already operate captive insurance companies see commissioners of a number of the States who are requiring, where they did not in the past, letters of credit to back up those premiums that are paid where reinsurance is at stake. I think some of those things are happening already as a result of the insurance crisis, even though total implementation is not in place, but it is well on the way.

I think this is a good point that has been brought out.

Mr. ANTHONY [presiding]. Thank you very much.

Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Anthony.

Just to followup, do captive companies have much to do with reinsurance companies in any way whatsoever?

Mr. HOUSE. Yes. As a matter of fact, captive companies are both primary companies as well as——

Mr. GUARINI. And use reinsurance at the same time?

Mr. HOUSE. Yes. So to the extent there are problems in the primary companies, captives are having the same problems. But captives who are captives to a specific industry and were started for a specific reason normally deal with loss control and claims control more quickly and more intimately than a larger commercial carrier.

Therefore, you know where there is a problem a little quicker than the major companies might.

Mr. GUARINI. What are the disadvantages of a captive company?

Mr. HOUSE. The disadvantages, in the early days many captives were not funded properly. They could be started in numerous jurisdictions with limited capital.

Mr. GUARINI. Are most captive companies offshore?

Mr. HOUSE. Most captives are offshore.

Mr. GUARINI. Why are they offshore? Because they take advantage of the tax laws of Bermuda?

Mr. HOUSE. I think that was initially a point, however a long time ago that ceased to be the reason. It largely became a point where they could provide the type of coverage they needed.

They could secure the opportunities of freedom of operating within the society and had a better opportunity to provide a broader spectrum of coverage.

Mr. GUARINI. Like they do in Pennsylvania or Connecticut.

Mr. HOUSE. They do not have a law that would allow groups to insure.

Mr. GUARINI. Assuming it is a State that does allow.

Mr. HOUSE. You see that coming into effect now, for example, in Vermont there is a tremendous increase. Last week there were 12 or 15 captives on the desk of the chief examiner there.

Mr. GUARINI. Is it a trend to move domestically away from Bermuda and the offshore areas?

Mr. HOUSE. I think there is. I think we see considerably more interest in that area. I wouldn't say there isn't further interest in Bermuda, the Caymans or other offshore entities. It depends on the risk. Those companies particularly that are international in scope may wish to stay offshore.

Mr. GUARINI. Is it because they are tax-free havens that they can reinvest any surplus moneys they have without any income tax?

Mr. HOUSE. That is true that Bermuda and some of the other home bases can operate that way. On the other hand, reinsurance is available in some of those areas.

Bermuda has a group of captives who have come together and developed their own reinsurance pool where they share each other's risks. This is good because it has developed additional capacity.

Mr. GUARINI. Let me ask, Mr. Havens, your company was criticized very heavily by Mr. Nader. What do you understand the basis of American criticism or consumers' criticism toward Lloyd's of London?

Mr. HAVENS. I would not equate the criticism I heard this morning with those of the consumer. I would basically maintain the criticism we heard this morning is groundless.

It adds to the rhetoric without responding to the factual circumstances that actually exist.

Mr. GUARINI. What point do you understand he was making, Mr. Havens?

Mr. HAVENS. Well, I have been trying to determine since January exactly why they felt by castigating Lloyd's they would advance the consideration of this issue here. Quite frankly, Mr. Guarini, I am at a loss for determining how that adds to anything.

Mr. GUARINI. Is there any valid criticism of Lloyd's that you can state for the record?

Mr. HAVENS. I would maintain there is no valid criticism in the Nader/Hunter statements that have been made before this or any other congressional committee and we have attempted to respond. We have brought underwriters over. We have submitted lengthy testimony.

This is now at least the fourth congressional hearing and we have appeared throughout the country in effect with Mr. Nader and Mr. Hunter.

Mr. GUARINI. Your trust fund of $6 billion is registered like any other insurance company within our 50 States?

Mr. Havens. No, it is quite different. In fact, I would maintain it is held to a much stricter standard. All the U.S. premium income to Lloyd's passes into that trust fund and remains for a period of 3 years before they determine whether any profit was made on that business and any profit can be returned to underwriters.

Mr. Guarini. You have no Federal regulation, do you? It is basically each individual State you are operating in that you have to file your reports with?

Mr. Havens. There is also Federal regulation by the Treasury. On the surety bond area where Lloyd's files a certified statement every year, the Department of Transportation and some of the other agencies also inquire as to the quality of Lloyd's.

Mr. Guarini. Lloyd's has 2,800 backers, you say, and they get these backers to pick up some of the risk. Is that how it generally operates?

I am asking you whether or not you lose any of these backers as a result of what has happened lately. Has Lloyd's lost some of its reinsurance base?

Mr. Havens. To answer your first question, a slight correction. There are 28,500 names or individuals, over 2,400 are U.S. American citizens. All of these people pay U.S. taxes on the profitable——

Mr. Guarini. These are people who give you the financial support?

Mr. Havens. Yes.

Mr. Guarini. Because of the reinsurance crisis we may have throughout the world, these people pulled away their support, their moneys from backing Lloyd's of London?

Mr. Havens. The way it has worked is that the managers of their money have put them into different lines of business perhaps where they have a greater prospect for making money. In fact, some——

Mr. Guarini. Have you lost some of your base?

Mr. Havens. Some have dropped out, other new investors have come in.

Mr. Guarini. No better, no worse off.

Mr. Havens. In fact, there is additional capacity but we don't know the reasons why people drop out.

Mr. Guarini. Mr Nader said that what Lloyd's does, the rest of the reinsurance world seems to do, that they set the pace for what happens and they pretty much control the action globally. Would you characterize that as a fair statement?

Mr. Havens. No, I would say it is flattering.

I think the witness who appeared recently from the General Reinsurance Corp. would take great exception. They probably regard themselves as the U.S. leader. It is true that a number of respected underwriters and syndicates at Lloyd's love whenever possible to develop new coverages for existing risks.

Mr. Guarini. Mr. Maisonpierre, is there a disappearing of the support of the reinsurance markets throughout the world as a result of what is happening or has the increase in the premium rates kept people interested and back in the business?

Mr. Maisonpierre. I don't think that there has been a disappearance in the world, Mr. Guarini. I think what has happened is that as a result of the temptations to get into the U.S. reinsurance market in the late seventies and early eighties, a number of companies, both domestic as well as quite a large number of foreign companies, entered a market and provided some rather tempting reinsurance rates as a result of which many companies, primary companies, because reinsured with those newly formed entities.

Those entities today are no longer that attractive. Concern has been expressed as to their ability to deliver on their insurance contract because one of the points which has been made about reinsurance, it is a long-term business. Loss developments are very slow and it will be 20 years or so before those companies can actually be required to make payments on their contracts.

If a reinsurance company is not available 20, 25 years from now, then it is a net loss insofar as the primary company is concerned. More and more primary companies have increased what they call their security standards, the standards which they use to judge the solidity of a reinsurer.

Mr. **Guarini**. A reinsurance company contracts with the primary insurer so, therefore, the primary insurer needs the support of the reinsurer. He has to give away certain things that he may be reluctant to give away, but which gives an advantage to the fellow who holds the money. Is that a fair statement?

Mr. **Maisonpierre**. That is right.

Mr. **Guarini**. So, therefore, your experience rate would be different than the experience rate of the primary insurers.

Mr. **Maisonpierre**. It will be very different, sir.

Mr. **Guarini**. What has happened? Has the reinsurer come out as bad as the primary insurer in the last insurance crisis or the present insurance crisis or are they still making a good return on their money?

Mr. **Maisonpierre**. Our statement goes into detail in this area. The reinsurers have come out considerably worse than the primary companies. Again, in 1984 the reinsurers return on equity was a negative 14 percent as against a negative 3 percent for return by the primary companies.

Mr. **Guarini**. You take the same proportion in reserves and put away the same reserves the primary insurer puts away?

Mr. **Maisonpierre**. Our reserves are based on the reinsured loss expectations. They are probably greater than those of the primary company because under today's reinsurance concept, reinsurance is sold on an excess of loss base. We provide the coverage for the high losses. Those losses, on the other hand, are only supposed to occur very, very seldomly, little blips in the system.

Mr. **Guarini**. But in a separate case where there is a reserve set aside to pay a claim out, the primary insurer sets aside a certain amount of money in reserves. Do your reserves have the same ratio of loss that they decide or do you do what you think you have to do within your own system?

Mr. **Maisonpierre**. We examine our own reserves separately. What the primary company will do, it will set its reserves up to the limit of its retention which may be less than its potential liability. We set our reserves from that point up to our limits and we set our own reserves on those cases.

Mr. GUARINI. But the person who sets the value of the case is the primary insurer? You set one value because your opinion may be different than theirs and set aside a bigger reserve than a primary insurer who may set another value on a particular case.

Mr. MAISONPIERRE. The primary company will set a reserve which is limited to its retention and will notify us of the decision.

Mr. GUARINI. I agree with that, but there has to be a uniformity of bases as to how much is set aside as reserve. You have a file that is worth a $500,000 loss. Would the primary insurer, depending upon their evaluation of the loss of the file, the cost of the loss, be the same as your evaluation or are you on two different levels all the time?

Mr. MAISONPIERRE. We would be on the same base. What happens is that one of the functions of the claims, the claims function of a reinsurer is to periodically audit the files of its clients and it will go through its claim files and will set up, they will discuss the values of claims involving the reinsurer.

Mr. GUARINI. Is that how Lloyd's of London works, Mr. Havens?

Mr. HAVENS. I appreciate the opportunity to respond.

First, one small correction. Mr. Maisonpierre, I believe, inadvertently misspoke.

The primary company will only set its reserve to the limit of its liability, not its policy limits. The primary insurer has the obligation to notify the reinsurer when it has experienced a loss that will involve the reinsurer. The reinsurer, then, guided by the primary company's initial assessment, determines its own assessment of what the reserve should be.

It is not a redundant resetting of the same reserves as the primary.

Mr. GUARINI. It is uniform in the evaluation of the loss.

Mr. HAVENS. Not necessarily. The reinsurer ultimately has to make his own determination that it has set an adequate reserve.

Mr. GUARINI. You can have the advantage of having a larger tax shelter than the primary insurer based upon your own evaluation of what you have.

Mr. HAVENS. Experience has not worked out that way.

Mr. GUARINI. Thank you.

Chairman PICKLE. Thank you, members.

Mr. ANTHONY. Mr. Chairman, I forgot two quick questions I would like to get on the record, one to Mr. Havens.

You have got $6 billion sitting in a bank but not, according to the song—Larry Gatlin will be disappointed to know—in a bank in Beverly Hills, but it is up in New York.

What has been your payout out of that reinsurance trust fund over the last 2 to 3 years? You have got $6 billion there to take care of all your claims.

Mr. HAVENS. I will generalize my answer.

As I indicated, Lloyd's is on a 3-year system. What this means is that it is a more conservative accounting system so that you will not declare dividends to your policyholders or owners unless you have a better idea as to whether you actually made money, if it takes 3 years to settle the automobile case.

Now, by doing that, you are also a couple years behind the American system. But, conversely, you have a better idea whether you made money in 1982, the most recent year for which final statistics are available.

Now, it varies on a syndicate-by-syndicate basis. In some years, the money in New York was more than adequate to pay the losses. It is possible that for some syndicates it was not, and additional collections had to be made from the underwriters to pay these losses. The delay in payment, though, prevents me from generalizing in any given year how any given syndicate did.

Lately, as testified by the underwriter, Mr. Richard Hazell, before Senate Commerce, Lloyd's experience mirrors the U.S. experience.

Mr. ANTHONY. In the liability area?

Mr. HAVENS. In the general liability area.

Mr. ANTHONY. You were profitable in all other insurance areas?

Mr. HAVENS. Profitable or break even. It was very close in some instances.

Mr. ANTHONY. Maybe some of our domestic companies will take 1985 and 1986 as a learning experience and start being a little bit more conservative in their pricing and in some of their underwriting practices.

If we go totally to a claims made contractual relationship, where am I treated differently under claims made policy?

Mr. HAVENS. You, as the policyholder?

Mr. ANTHONY. Yes.

Mr. HAVENS. Basically, you go on a pay-as-you-go basis under claims made. The claims made forms that have been upheld basically have been the ones that have provided some coverage for events that occurred before that you may not have insurance for.

But assuming that starting today you buy a claims made policy and you continue to buy claims made policies, both you and your insurer will know whether you have made a claim and whether that was profitable or unprofitable for the insurer, and you will have a better indication instead of waiting under the occurrence basis for an event that occurred 20 years ago and a claim to be made now in which you clearly did not, the insurer did not, charge enough for that risk. You will have a far better idea both as an insurer and as a reinsurer as to how each is doing.

Mr. ANTHONY. How do we take care of the social problem, though, of an asbestos case or toxic carcinogenic element that is out now, but it takes such a long period of time before the harm is actually recognized?

Mr. HAVENS. Asbestos is one area where Lloyd's underwriters took the same red ink bath as the U.S. insurers, and they are very actively supporting the Wellington Commission and the combining and treatment of those claims in a joint fashion, so that fair and adequate settlements can be made to the claimants.

Mr. ANTHONY. Thank you very much, Mr. Chairman.

Mr. Chairman, with your permission, I would like to say a special welcome to Mr. Eubanks, insurance commissioner from the State of Arkansas, for accepting our invitation to come and share with us his expertise.

Chairman PICKLE. Glad to have you here, Mr. Eubanks.

We also welcome Mr. Lawrence Merrill, the deputy executive director of the Michigan Townships Association in behalf of the National Association of Towns & Townships.

We will ask Mr. Eubanks if you will proceed with your testimony first.

STATEMENT OF ROBERT M. EUBANKS III, INSURANCE COMMISSIONER FOR THE STATE OF ARKANSAS

Mr. EUBANKS. Thank you, Mr. Chairman.

As you know, my name is Robert Eubanks, insurance commissioner for the State of Arkansas. I applaud and appreciate this committee's concern regarding liability insurance availability and affordability.

Representative Anthony was quoted in my local paper as saying that this problem was not created by the Government, and probably should not be solved by it, but we do have a responsibility to define the problem and press those who have the power to resolve it.

Congressman Anthony could not have been more on target. The story of the property and casualty market in 1986 was written years ago, the results of which bring us together today. The underwriting side of the business should not be blamed because of underpriced coverages. The manual rates were available, but they were ignored.

Insurer attempts to price include not only economic assumptions for the future, but now changes in the law and social expectations.

Investment income, which Arkansas mandates insurers account for in the ratemaking process, lent some stability to the balance sheets during the years of rigorous competition. However, most insurer pricing was done on the front line between the agent and the company. The emphasis for the bottom line was investment income and not risk underwriting.

These years of underpricing have become unbearable. Several large insurers who may have had an upstream contributor or parent to help balance the books during the soft market and, hence, maintain low prices must now stand on their insurance operations alone.

In its broadest sense, the underwriting process determines how much cash can come in and be invested, and how long it can be invested, and finally how much of those funds and interest are left over after losses and expenses.

One substantial variable to the property and casualty industry is the availability of reinsurance, as you just heard. Arkansasans have experienced premium increases, midterm cancellations, nonrenewals, and areas where coverage is either limited or unavailable at any price.

The Government has acted before in these times of crisis, as evidenced by our State automobile and workers compensation, assigned risk pools. In Arkansas, in 1985, a joint underwriting association or pool was enacted for consumers who live in rural areas of our State who could not obtain property insurance.

For liability insurance, our department issued regulations that provided sanctions when an insurer attempts to cancel or nonrenew. Rates have been regulated in Arkansas since 1979 under a competitive rating system, and consumers in our State have enjoyed several years of very low premiums for their liability insurance.

We believe our rate regulatory system is a fair and workable one, but we do plan on proposing modifications that will enhance our ability to control the substantial swings in premiums.

The reform of our civil justice system is a timely area for debate. In Arkansas, a mandated alternative dispute resolution system would require a change to our State constitution. Our statutes do not allow now for prejudgment interest. Our rules for procedure in class actions and discovery mirror the Federal rules which the insurance industry supports. We also allow an optional exclusion for punitive damages.

While a cap on pain and suffering awards would be redundant in Arkansas at this point in time, it is time to consider the issue. We do have joint and several liability, and our product liability laws are open-ended. Contingent fee limits, which have been enacted in other States, I would be willing to support what I am satisfied that would in no way limit the access to our courts to the detriment of the lower income citizens. While many areas of insurance are limited greatly in capacity, my office has been very effective in helping maintain or obtain liability coverage.

The real problem in Arkansas is affordability. The consumer is my first and foremost concern, and I feel their hostility each and every day. Affordability has had a chilling, devastating effect on the Arkansasans' dream of owning their own business. While a survey of Arkansas licensed insurers indicates a unanimous willingness to underwrite a business policy, the premiums of today are postponing or very likely killing that dream, not to mention the effects on our small and medium sized manufacturers in their struggle to keep their doors open.

I must also be concerned with rate adequacy and insurer solvency so the consumer will have a market to go to. The Arkansas Property and Casualty Guaranty Fund assessed companies licensed to sell that business in Arkansas almost $10 million in 1985, and 20 companies licensed to do business in Arkansas were liquidated.

I recognize that some companies are very profitable, but the industry as a whole has suffered from poor management, limited price regulation and increased costs. With the data processing ability now being provided by the National Association of Insurance Commissioners, the ability for State examiners to have onsite access to that capacity and, hence, provide timely financial information will now be available.

Legislation in every State is being addressed to insurers. The industry has lost much credibility and it will pay a price of increased regulation.

I do not—and I repeat—I do not see a quick solution to this very grave problem. I do think that the lessons we have learned are being put to good use. The property and casualty industry has always gone through cycles of underwriting profit and loss. The regulators and the National Association of Insurance Commissioners must act now to ensure that the violence of this cycle will never be repeated.

Thank you, gentlemen.

[The prepared statement follows:]

STATEMENT OF ROBERT M. EUBANKS III, INSURANCE COMMISSIONER FOR THE STATE OF ARKANSAS

Chairman Pickle and members of this Subcommittee, my name is Robert M. Eubanks. I am Insurance Commissioner for the State of Arkansas.

I applaud and appreciate this Committee's concern regarding insurance availability and affordability, particularly with respect to commercial liability insurance.

Representative Anthony was quoted in my local paper as saying that this problem wasn't created by the government, "and probably should not be solved by it, but we do have responsibility to define the problem and press those who have the power to resolve it." Representative Anthony could not have been more on target.

The story of the property and casualty market in 1986 was written years ago. The industry was then in the midst of one of the most competitive markets in history, the result of which bring us together today. Most of the business written in the past decade has been casualty. These lines have long periods of exposure, and even assuming a modest rate of inflation the damage tends to compound with increasing litigation costs. The underwriting side of the business should not be blamed because of underpriced coverages, especially in the casualty market. The manual rates were available but were ignored.

The growth of the casualty market at a time when the period of uncertainty is longer and the consumer more insurance sophisticated and demanding requires very fine pricing judgement. It becomes extremely important how you underwrite a risk when you price the risk this year and settle out the loss in year sixteen. Insurers attempt to price now, and include not only economic assumptions for the future, but changes in law and social expectations. Changes that may be very desirable in terms of society can be quite damaging to an entity who has taken on a fixed obligation which matures after that social change or expectation takes place—what insurers call social inflation. An example of this is the drunk driving issue; this is most beneficial to society but the expansion of liability and culpability has been costly to those who buy and sell liquor liability insurance.

As the industry grew in both dollar volume and sophistication, new ways to manage the monies while expanding coverage and "lines" of business evolved. Investment income, which Arkansas mandates that insurers acount for in the ratemaking process, lent some stability to the balance sheet during the years of vigorous competition. However, most insurer pricing is done on the front line - between the agent and the company. Investment income is a management decision. Creativity and an environment of high inflation and interest rates led to the establishment of underwriting departments as a seperate entity within the company charged only with bringing in the premium dollars, as much and as many as possible. Much of the pricing was based on the market share principle, with management and the investment portfolio a separate entity. The new emphasis for the bottom line was investment income and not risk underwritng.

These years of underpricing have become unbearable, especially in light of the increased frequency and resulting costs of litigation and the changes in the corporate structure of many insurers. These past years we have seen a cascade of mergers and dissolutions between insurers and non-insurer entities. Several large insurers who may have had an upstream contributor or parent to help balance the books during the soft market, hence maintaining low prices, must now stand on their insurance operations alone for the bottom line results. Underwriting is even more important now because it is the most important determinant of investment income. Those investable funds will come from the underwriting cash flow. If underwriting is not done properly, there won't be enough investment income. In its' broadest sense, the underwriting process determines how much cash can come in and can be invested, how long it can be invested, and finally how much of those funds and interest are left over after losses and expenses are paid.

Action was taken in insurers underwriting departments last year to achieve price recovery. We have all experienced the subsequent result in premiums we pay if coverage is available. One substantial variable in the property and casualty industry is the availability of insurance for insurers, or reinsurance. The role of reinsurance in today's market cannot be discounted. We have seen the affects of the availability of reinsurance through the eyes of the insurer who cannot operate without it and through the eyes of the businessman whose essential coverage was interrupted because his insurer no longer had coverage.

It is difficult to determine the exactness of the rate increases taken because of the changing mix of policies and coverages and because of the subjective rating criteria utilized on an individual policy basis. Arkansasns have experienced premium increases, mid-term cancellations, non-renewals, and areas where coverage is either limited or unavailable at any price, as has the rest of the country. When the private insurance mechanism breaks down, as it has, government must act to strengthen or replace the private insurance system. Government has acted before in these times of crisis, as evidenced by our automobile and workers' compensation assigned risk pools. In Arkansas, during the 1985 special legislative session, a law was enacted that established a joint underwriting association, or pool, for consumers who live in rural areas of our state who could not obtain property insurance. For liability insurance, our Department issued a Directive and a Bulletin that provided for administrative sanctions when an insurer attempts to cancel or non-renew except for wrongdoing by the insured or a dramatic change in the risk.

Rates have been regulated in Arkansas since 1979 under a "competitive rating" system, and consumers in our state have enjoyed several years of a soft market. One of the indices of how well a competitive system is working is the ease of entry and exit into the market and the position in terms of market share by insurer. We believe our rate regulatory system in a fair and workable one, but we do plan on proposing some modifications that will enhance our ability to control the substantial swings in premium cost to the consumer.

The reform of our civil justice system is a timely area for debate and is a subject to be viewed on a state by state basis. In Arkansas, a mandated Alternative Dispute Resolution for small claims would require a change to our state constitution. Our statutes do not allow prejudgement interest; our rules of procedure for class actions and discovery mirror the federal rules which the industry supports. We allow policies with an optional exclusion for punitive damages. While a cap on pain and suffering awards of two hundred and fifty thousand dollars would be redundant at this point in time it is timely to address the issue now. We do have joint and several liability and our product liability laws are open-ended. Contingent fee limits have been enacted in other states and I would be willing to support a similar proposal in Arkansas when I am satisfied that it would be in no way limit the access to our courts to the detriment of the lower income citizens.

We in Arkansas do not have the statutory authority to operate a formal Market Assistance Program or MAP. The Department of Insurance does survey, on a monthly basis, companies writing over seventy-five percent (75 percent) of our commercial liability market. We provide the form and specify the lines of insurance of interest. The companies provide a yes or no answer to two areas; new business—yes or no, and renewal business—yes or no.

While many areas are limited greatly in capacity, my office has been effective in helping maintain or obtain liability coverage. The real problem in Arkansas is affordability. I must wear two hats now and it is not comfortable. The consumer is my first and foremost concern and I feel their hostility each and every day. Affordability has had a chilling, devastating effect on the Arkansans' dream of owning your own business. While our survey indicates a unanimous willingness to write a Businessowners Policy, the premiums of today are postponing of very likely killing that dream, not to mmention our small and medium size manufacturers and their struggle to keep their doors open.

I also must be concerned about rate adequacy and insurer solvency so the consumer will have a market to go to. The Arkansas Property and Casualty Guaranty Fund assessed companies licensed to sell that business in Arkansas almost ten million dollars in 1985. Twenty (20) companies licensed to do business in Arkansas were liquidated. We anticipate twenty (20) more liquidations in 1986. This past week I suspended the licenses of four companies to operate in Arkansas, further constricting our available markets.

I recognize that some companies are very profitable but the industry as a whole suffered from poor management, limited price regulation and increased costs.

With the data processing now being provided by the National Association of Insurance Commissioners, and the ability for state examiners to have on-site access to that capacity, timely financial information will be available. Legislation in every state is being addressed to further regulate insurance. The industry has lost much credibility and it will pay a price of increased regulation.

I do not seek a quick solution to this very grave problem. I do think that the lessons we have learned are being put to good use. The property and casualty industry has always gone through cycles of underwriting profit and loss. The state regulators and the National Association of Insurance Commissioners must act now to make certain that the violence of this cycle will never be repeated. Thank you for this opportunity.

Chairman **Pickle**. Thank you.

Mr. Merrill.

STATEMENT OF LARRY MERRILL, DEPUTY EXECUTIVE DIRECTOR, MICHIGAN TOWNSHIPS ASSOCIATION, REPRESENTING THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS

Mr. **Merrill**. Thank you.

Mr. Chairman, members of the subcommittee, my name is Larry Merrill. I am the deputy executive director of the Michigan Townships Association, representing the National Association of Towns and Townships, which represents over 13,000 small local government communities from around the country.

The vast majority of our members have populations of under 25,000. The officials in the leadership positions of these local governments range from those who have been elected and serve on a salaried basis, to those who are volunteering their time and serve without remuneration, just as a service to their community.

Mr. Chairman, at this point I would ask our prepared testimony be submitted for the record, and I would like to talk with you for just a few minutes about our perception of the liability problem.

Chairman **Pickle**. Without objection, your statement will be in the record.

Mr. **Merrill**. Thank you.

The liability crisis facing local units of government is perhaps the biggest problem they are facing today. As I heard earlier in testimony, the problem is twofold. First is the availability of liability insurance for local units of government.

In Michigan, 60 percent of all our 1,820 units of government have had their insurance canceled since last April. Most of these units of government would be considered good risks if they were looked upon on an individual basis, and most of them have had no prior loss history.

The second problem is one of cost. Some local units of government, primarily the smallest—which provide just a basic level of service, are still paying astronomically high rates compared to what they have historically paid. We have had reports of anywhere from 50 percent to 1,000 percent increase in insurance premiums. Also, the coverage has been restricted and limited in the areas of umbrella coverage, for example.

It is very difficult, if next to impossible, to get any coverage over $1 million; and many areas which were previously covered are now excluded. An example is a township fire department that I have worked with which provides only fire protection. It is not a general purpose unit of government.

Under Michigan law, they are provided a wide variety of governmental immunity, yet their liability insurance is now one-third of their total operating budget—about a 300-percent increase over their prior year premiums.

The effects have also been very widespread. A survey done by our Kansas association indicated a wide number of public officials at the local level seriously considering leaving public office because of the fear of losing their personal assets. Nationwide, the costs have been escalating, and many local units of government have been forced to cut back essential services in order to pay insurance premiums.

It is also making a lot of local officials excessively conservative in their decisionmaking. One township I work with in a rural part of Michigan was on the verge of forming their own ambulance department because ambulance protection was 45 minutes away. They decided that the lack of liability insurance for that operation will require them to no longer even consider providing that type of service.

The city of Lansing is considering stopping any fire inspections in homes because of the liability if they happen to overlook something.

Perhaps the watershed case facing local governments involves Jackson Township in New Jersey where 97 residents won $5.8 million over a pollution case where there was ground water contamination, and the insurance companies covering the township were forced to pay more money than they actually had the township covered for.

The problem seems to be facing local units of government because of the number of claims filed, the size of the awards, and particularly from the insurance industry standpoint, the high degree of uncertainty. No one knows what the extent or limitations on governmental liability may be 1 year to the next.

We are proposing to Congress that local units of government do deserve special consideration in their exposures; for several reasons we should be considered different from private industry. For one thing, we provide services that the free market can't.

Public officials, especially at the local level, do not profit personally from the decisions and the risks which they might have to take. They can't simply pass their costs on to constituents. And even if they could, I don't see what the justice would be in that.

Finally, if the local unit of government is facing astronomical court claims, they can't simply go out of business. The public services still must be provided.

To address this issue, our national association held a summit in January to explore problems and proposed Federal solutions. The White House, both Houses of Congress, the industry and government were represented. Several areas were identified where the States cannot resolve this issue. One has been the broadening of interpretation of section 1983 under the Federal Civil Rights Act.

In 1961, there were 250 civil rights suits pending in Federal court. Last year, 241,842 suits were filed.

Our association feels very strongly that the intent of section 1983 must be upheld, but its significance is being considerably diluted when it becomes just another bargaining chip for any person who is dissatisfied with local units of government. Consequently, we feel some very narrow definitions could protect its original civil rights intent and also to protect local units of government in some of the economic areas and where it is being used for commercial purposes.

In the other area that was mentioned—regarding environmental impairment—local units of government are holding a perpetual liability, too, in Federal law. We don't have the resources to pay the kind of damage claims Jackson Township had. So we would urge that perhaps Congress look at indemnifying local units of government operating landfills similar to the way EPA indemnifies their subcontractors.

We also might urge that Congress look at the Federal Government becoming the insurer of last resort. There are certainly precedents areas such as flight insurance and flood insurance. Some of the mistakes made in those programs could be changed to make the programs self-funding.

Again, I would like to thank the committee for looking at this problem, and we would certainly stand willing to work with you further on this.

[The prepared statement follows:]

STATEMENT OF LARRY MERRILL, DEPUTY EXECUTIVE DIRECTOR, MICHIGAN TOWNSHIPS ASSOCIATION, ON BEHALF OF NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS

Mr. Chairman and members of the subcommittee, I am Larry Merrill, deputy executive director, Michigan Townships Association, representing the National Association of Towns and Townships, an organization of over 13,000 towns, townships and small governments nationwide. The vast majority of the communities we represent have populations under 25,000. Officials in leadership positions range from those who have been elected and are on a salaried basis, to those who are volunteering their time without any remuneration whatever, and who do so as a service to their friends and neighbors in the community.

We are struggling to deal with the liability crisis situation. In the past year, local governments throghout the country have seen the municipal insurance field virtually collapse—municipal insurance rates have climbed 50 percent, 100 percent, 200 percent, and in some cases 1,000 percent. And to make matters worse, there are but a handful of insurance companies that today are willing to write municipal insurance at all.

An additional threat is that to local officials personally who, is their community cannot get liability insurance, may find themselves and their assets the target of lawsuits. This is not a minor concern, as evidenced by a survey done earlier this year by our Kansas Association. Their members are rural, mostly farm communities with very low budgets and mostly volunteer officials.

Junction township in Osage County, for instance, says, "We need public official insurance that is cheaper. If we don't get some relief we won't have anyone to run for public office."

From Elk Township in Osage County: "We need more insurance coverage and cannot get it. Insurance cost is getting prohibitive. We applied at five different insurnce companies or agents for directors' insurance and no one will write it. If we cannot get this insurance we are going to resign. We have not had a claim."

Rinehart township in Dickinson County: "American States advised us they will no longer renew this coverage. Insurance should be cheaper and more available to elected township officials. If insurance becomes harder to get no one is going to serve on a township board."

Logan Township in Meade County: "Both companies have cancelled the policies I don't know how the townships can afford too much more insurance costs. We'll have a hard time getting officials to serve on township boards if we get in any law suits."

From Grant Township in Decatur County, "We cannot keep insurance. We have had three different policies in three years. We have never had a claim. No company wants to insure township."

Lake Township, Harvey County: "Our liability insurance for the board members is being cancelled out and is not renewable."

An official from Grainfield, in Gove County is "being sued as an individual, because the township does not carry liability insurance."

Fowler Township in Meade County: "I may resign rather than have to risk my own worth for a township."

Out of the 105 responses to this survey, 45 expressed alarm and concern that they would not be able to renew their policies, twenty-five were unable to get insurance, and eight indicated they were losing or had lost board members as a result.

Examples of our premium increases—as I mentioned, another major problem—include these from the State of Pennsylvania—typical of what is occurring across the country.

In South Lebanon Township, Lebanon County, the insurance premium has more than doubled, from $22,000 to $46,000.

In Hopewell Township, York County, liability insurance costs increased from $6,000 to $8,650, a 26 percent increase in a single year.

In Haverford Township, Delaware County, renewal of all insuraance has increased from $225,000 to $460,000.

The liability coverage for the city of Harrisburg's steam plant generator increase from $48,000 in 1984 to $85,000 this year.

In Mechanicsburg, the annual cost of insuring the borough increased from $35,300 to nearly $95,000 in a single year.

In New Cumberland, the cost of providing coverage increased from $18,000 last year to more than $30,000 this year.

In Bellefonte, Centre County, the cost of general liability coverage increased from $8,100 last year to nearly $26,000 this year, an increase of 213 percent.

In Media, Delaware County, the cost of coverage for public officials increased from $7,500 in 1984 to more than $25,000 this year.

In Scottsdale Borough, West Moreland County, the cost of liability insurance increased from $7,300 to nearly $25,000 in just a year.

In Glendon, Northampton County, a borough of 360 population, the cost for liability protection jumped from $252 in 1984 to $2,500 this year, an increase of 852 percent. While the $2,500 price tag may not appear excessive, it is significant to a municipality that has no police, no volunteer fire company, no road crew and an annual budget of only $65,000.

In Dover Township, York County, the township was assessed a $25,000 inspection fee and a $10,000 "interim fee," over and above the insurance premium.

In Meadville, city officials saw their police professional liability policy cancelled three times. The last termination was made on a ten-day notice. To compound matters further, the cost of the policy had increased more than 100 percent while the coverage was reduced from one million dollars to five hundred thousand dollars.

In the city of Allentown, officials saw their coverage reduced from 35 million dollars to 5 million dollars for general liability and one million dollars for police professionals. And yet, the cost for all types of coverage increased form $185,000 to $500,000.

The list of horror stories goes on and on. In most cases local officials simply have been unable to renew their liability insurance with a carrier that will provide adequate coverage at a reasonable cost.

And as you have heard, particularly in smaller municipalities, there is often no carrier interested in providing needed coverage.

As the availability and affordability of municipal insurance continues to become more uncertain, the consequences for the country's local governments and their taxpayers could be devastating.

The particular case most often singled out as influencing the changes in our current marketplace occurred in Jackson Township, New Jersey, in 1963: A case which has reverberated clear across the United States and as far as Lloyds of London. It was in Jackson Township that 97 residents claimed their drinking water had been contaminated by chemicals leaking from a landfill which had been closed years earlier by the Federal environmental protection agency.

The citizens were successful in their litigation, and a jury awarded them 15.8 million dollars—later reduced to 5.8 million on appeal because of the court's precedent-setting interpretation. Companies insuring the township were forced to pay the full award despite the fact that the policy they had issued amounted to only one million dollars.

As a result of the Jackson Township case, one insurance company in Pennsylvania canceled three hundred municipal policies in that State alone. And I would like to point out, Mr. Chairman, that often we are finding policies completely canceled whether or not the municipality has ever filed a claim.

Of course the Jackson Township case is not an isolated instance. Every day, local officials are becoming frustrated and frightened by the enormity of the crisis. Our resources are being stretched to the limit and in many cases—especially with the implications of Gramm-Rudman-Hollings and the real threat to general revenue sharing all coming on at one time—our very survival as an adequately functioning unit of government is in question.

Let me speak for a moment from the perspective of a small town official who, in the face of increasingly burdensome mandates from the Federal Government, the downturn in our rural economy and the proposed loss of our only Federal assistance, is trying to hold a community together. Extreme as the situation may be for private business, municipalities across this country are faced with an even more complex problem. Choices exist for the private sector that are not available to us. Perhaps they can come up with higher premiums by raising prices; they may be able to self-insure; and in a worst-case instance, they can go out of business. We are a government, however, charged with the responsibility to provide essential services like police protection road repair, health services, a fire department—and we do not have that option.

A town or city cannot go bankrupt, Mr. Chairman. So what can we do? For the most part, self-insurance is not an alternative for towns and townships, because we have such limited budgets—we don't have the flexibility in the revenue sources that larger cities have. Because so many of our local officials are part-time and volunteers, we are more vulnerable to having them resign from office. In other words, we can't afford the current situation—we can't afford the alternatives—and we can't afford to lose our leadership.

There does, however, remain one other alternative—if you can call it that. We can go without insurance coverage until we can afford it again, as communities across the country are doing today. This leaves municipalities totally vulnerable, and puts an intolerable burden, should claims arise, on local officials and individual citizens. As you have seen, the enormity of this situation is causing us to lose good volunteer town and township leaders who cannot accept this personal liability—and should not be expected to.

In an effort to come to grips with these issues, the board of directors of the National Association of Towns and Townships directed an investigation into the possibilities for Federal involvement in resolving the situation. As a result, on January 14, 1986, we convened and facilitated the first meeting of representatives of local, State, and Federal governments, the insurance industry and other private sector interests. Participants in our day-long "liability summit" included representatives from:

White House Office of Intergovernmental Affairs:
Senate Committee on Environment and Public Works;
House of Subcommittee on Commerce, Transportation and Tourism;
Office of Senator Paul Simon;
Office of Congressman John Porter;
U.S. Department of Justice;
U.S. Environmental Protection Agency;
City of Virginia Beach, Virginia;
U.S. Conference of Mayors;
National Association of Counties;
National League of Cities;
National Conference of State Legislatures;
Connecticut Council of Small Towns;
Pennsylvania State Association of Township Supervisors;
Maryland Insurance Division;
American Insurance Association;
Public Risk and Insurance Management Association;
National Insurance Consumers Organization;
National Rural Electric Cooperative Association;
National Solid Waste Management Association;
National Sheriffs Association;
Crum & Forster Insurance Companies;
Gardner, Moss and Hopper, Attorneys-at-law;
Arnold & Porter, Attorneys-at-law;
Risk Science International;
Risk Insurance Management Society.

The thirty-five participants at the summit examined the availability and affordability of insurance, the vulnerability of local governments to lawsuits under Federal environmental and civil rights statutes, and possibilities for federal action to solve the problems.

We focused on section 1983 of the Civil Rights Act of 1871 and on Federal environmental statutes, the sources of most requirements, litigation and judgements involving the Federal Government. These are areas where remedial action by State governments is not the answer, since if there is a cause of action against us in either section 1983 or the environmental area, the plaintiffs can sue in Federal court—thereby obviating the need to deal with the State courts. In essence, whatever the

States are doing to resolve the crisis—and many are very active—it is immaterial in those two areas, and we must look to the Federal Government for possible solutions.

The original basis for section 1983 was an human rights statute right after the civil war, which enabled the Federal Government to step in under the 14th amendment where State laws weren't being enforced. In the first hundred years of this law there were approximately 200 suits filed—but in the last year, under this law, there were twenty-four thousand suits filed, not including suits filed by prison inmates against the State for alleged civil rights violations. Many of these twenty-four thousand law suits have nothing whatever to do with traditional human rights. If you don't like, for instance, a local zoning decision, suits have been allowed under section 1983 alleging that your civil rights have been infringed. This interpretation of section 1983 has caused a real explosion in litigation, particularly since there are no caps on either attorneys fees or awards in the Federal court system under this statute. We even have reports that an allegation under section 1983 is being routinely added to suits under state law, just in case the State action fail(s).

You will hear a lot of horror stories about attorneys' fees at this hearing, I imagine. Just one example which was cited at our summit involved a case where a municipal employee sued for back pay and was awarded the money he asked for—$15,000—but there $400,000 in attorneys fees.

And the other problem—awards. Damages awarded under the doctrine of joint and several liability, for instance, are creating a tremendous problem, since damages can be collected from parties regardless of their relative percentage of responsibility. The burden generally comes to rest on local governments and their taxpayers—because the private party defendants seldom have adequate coverage. Here are some examples—just the tip of the iceberg, but enough to give you an idea—from New York State:

1. The injured party was a passenger in a car driven by a drunk speeder who struck a tree, who claimed defective road signs. The jury found the town to be 25 percent negligent and the driver 75 percent. The award was $910,000, of which the town's carrier paid $900,000. And the codefendant $10,000. (Town of Lagrange, Dutchess Co.)

2. A driver struck a bicyclist on a town highway. The jury found the town 5 percent negligent and awarded a total of $280,000. Nevertheless, the town carrier paid $230,000. (Town of Greece, Monroe Co.)

3. An uninsured motorist ran a stop sign striking another vehicle in the intersection. The only negligence attributed to the town was that the stop sign was 3 to 4 inches lower than the standard. The town carrier settled for $255,000 because of fear of greater exposure. (Town of Clarendon, Orleans Co.)

4. A town was held to be 10-percent negligent in $373,000 verdict, they paid $273,000. (Town of Lancaster, Erie Co.)

5. A vehicular accident on a town highway resulted in an award of $100,000. Although the town was held only 5-percent negligent, the town and carrier had to pay $85,000. (Town of Caledonia, Livingston Co.)

This brings us to our first recommendation, Mr. Chairman. We feel very strongly that it is important to research whether there is a chance for a surgical legislative remedy to amend, in a very narrow fashion, section 1983 so as to absolutely and completely retain the civil rights thrust of the original law but remove some of the non-human rights challenges that are now filed under the section.

Of course there is a danger in this that such an action might be considered an assault on the civil rights laws of the United States, and that should not be the interpretation. We strongly support retention of the entire civil rights thrust of section 1983. It is possible, however, that language in the original statute was not as precise as it might be today when we have a much broader historical base in civil rights statutes.

We have strong concern about what is happening under section 1983. It strikes us as part of a continuing assault on the status of local governments as partners in the Federal system. Specifically, an increasing attempt, through legislative and judicial interpretation to treat local governments as though they were some sort of business. It presumes that localities can raise their prices to deal with the judgment—prices, in this case, being local taxes—and that's not always the case, because of many requirements and ceilings of state laws. Or that they can withdraw their services, like a business could do—which they also cannot do, because their service levels are mandated by State law; or that they can go bankrupt, which they cannot do.

We face essentially the same problems in the pollution arena. In having to scramble for any kind of insurance protection they can find, many towns and townships have to settle for limits on coverage—higher deductables, lower potection levels, and exclusions of certain exposures, most often pollution exposures.

This exclusion of pollution coverage is of particular concern to those municipalities with landfills. The enormity of the impending financial danger becomes apparent when you consider the tremendous number of operating and previously functioning landfills across the country. Federal mandates hve forced us to accept this liability in perpetuity and have left us no tools to defend ourselves: No resources to fall back on except our severely strained property tax base.

We do have several other suggestions that the committee might want to consider, Mr. Chairman. The Federal Government might provide indemnification in the way EPA already does for its contractors at waste sites. Their contractors are indemnified, but local governments are not; and insurance companies have indicated they cannot see a situation in which they will reenter the environmental market, because even sanitary landfills potentially are hazardous waste sites—since household garbage contains all sorts of toxic materials.

Another option we explored at our liability summit—and something we feel is crucial to those of us who are trying our best to do a good job under these extremely difficult circumstances—is to establish federal standards of compliance in the environmental area, so that a local government will know that if it does everything the standards require it will have complete, or at least limited, protection. Without such standards, no matter what we do—no matter how much money we spend—no matter which high-priced consultants we engage or high-technology equipment we purchase—nothing will reduce our liability under the environmental laws.

The pressing, immediate need from the perspective of the Nation's towns and townships is for consideration of Federal intervention that will solve the liability problem at least for the short term, bridging the gap which exists between our present exposure and our ability to pay enormously inflated insurance premiums. We also need crisis intervention before localities are forced to "go bare."

As you know, Mr. Chairman, precedent exists in Federal law for the Government to act as insurer of last resort; we feel strongly that that option deserves another look. An opportunity exists now to learn from the mistakes of the flood and riot programs offered through HUD and the crop insurance programs offered through USDA, and to develop details of a proposal which would be an effective tool in this arena. Clearly, particularly under the present economic situation, such an initiative would have to be as self-supporting as possible.

There are also some suggestions coming from the State level which the committee might find valuable. Common elements appear in several proposals of which we are aware—these particular examples come from the experience of the States of Pennsylvania, Ohio and Michigan. They all contain or are considering proposals to:

Abolish or amend the doctrine of joint and several liability for governmental units;

Exempt governmental officers or employees from personal liability while engaged in the performance of their duties;

Modify the collateral source rule i.e., a procedure by which the court reduces the judgment by an amount equal to payments received from Government benefits, no-fault insurance and other sources;

Cap damages awarded for pain and suffering;

Provide for recovery by the prevailing party of costs and reasonable attorneys fees, if the court finds the action to have been frivolous or solely for harassment.

Also under consideration currently—in the State of Michigan—is the principle of proportional liability: Determination of a relative degree of fault among all parties through a formula applied by the court. In this case, although a local unit would always be responsible for its percentage of fault, it would be protected from those who consider local governments to have the proverbial—and mythical—"deep pockets." and therefore fair game and tempting targets.

Let me reiterate, Mr. Chairman, that although we see State legislatures making some progress, the problem with actions being brought under section 1983, and in the pollution arena, remain—and they will have to be addressed at the Federal level. Please remember that municipalities are under unique pressure as a result of this crisis and that we are facing an emergency situations every day. We would like very much to work with you, your staff and members of the committee to develop details of a quick and effective response to this national crisis.

Chairman **Pickle**. Mr. Anthony.

Mr. **Anthony**. Thank you, Mr. Chairman.

Mr. Eubanks, other States have required insurance companies to go into pooling or to join a pool as a part of doing business in your State. I know on page 4 of your testimony the State legislature gave you special authority to have joint underwriting associations, a pool for consumers who live in rural areas.

In Arkansas, do you have to get a State law passed each time you want somebody to go into a pool, or is this just——

Mr. **Eubanks**. Yes, sir. Yes, sir. We have—what I did when I wrote the legislation, I said after a hearing process then I could form this JUA. I have effectively used it as a hammer to hold over the industry's head and said if you don't write the business voluntarily, here is what you have got coming.

So far, we have been able to work voluntarily. But this is the only way to actually form a JUA in Arkansas that would be mandatory.

Mr. **Anthony**. Is that legislation broad enough that it gives you the authority to do that in other areas, or is it just in this one limited area?

Mr. **Eubanks**. It was in one limited area. We have since drafted legislation for our next session, as have many other States, to allow a critical area of need to be identified and a JUA formed for that critical area.

Mr. **Anthony**. Also, at the bottom of page 4 of your testimony you said you plan on proposing some modifications to the rate regulatory system that would enhance your ability to control the substantial swings in premium cost to the consumer. You have gone right to the heart of the problem.

Mr. **Eubanks**. Well, some States have excess profits laws which are a very time-consuming and costly mechanism for a State agency. Other States, like ours, which is smaller and handicapped by finance, we would have to go to a percentage limitation on filed rates as a cap.

We are a competitive rating State, and I hate to do that. When they file rates in Arkansas, they file them on an Arkansas basis, and then a national basis; and unless there has been some sort of abuse, the rates stand.

In certain lines of business, such as surety, where you are talking about a banker's blanket bond, a company could have a 2,000-percent profit in one year and discover that in three banks in the next year certain employees have been stealing for 5 years and the insurance company will have a dismal year.

So, there are many complexities and you have to look at it by line, I think. But we are not afraid to look at it by line and try to cap the balance.

Mr. **Anthony**. As I understand your testimony, you are saying there are some problems out there, and some problems ought to be addressed in a broad cross-section of areas.

I take it, though, you are saying it ought to be done on a State-by-State basis. You, as insurance commissioner of Arkansas, would rather have the authority to do it on a State basis rather than having the Federal Government step in and impose any type of Federal regulations.

Mr. **Eubanks**. Exactly.

Mr. **Anthony**. Do you see an oversight by the national Congress in any way assisting in helping you encourage your State legislators to give you the needed tools in order to better regulate the industry and therefore better serve the public?

Mr. **Eubanks**. The knee-jerk reaction that matches the industry's knee-jerk reaction to coverage and availability and pricing that will come from each legislature and it is going to be fairly devastating for the industry. They have guaranteed themselves probably a good dose of overregulation. Some sort of Federal oversight would be welcomed.

Some Federal programs have been beneficial. I question the way others might have been run.

I was just offered a $14,000 check for our Crime Prevention Program, and when asked how they arrived at the number they said there were 60 policies in Arkansas. Well, if that is how you distribute money and not based on risk or losses, then the Federal Government has got a lot to learn about insurance. And I don't want them to rush into something just because this is a problem now that might not be a problem 2 years from now. The Risk Retention Act frankly scares me.

Mr. **Anthony**. I am glad you brought it up. That was going to be my final question. What is your assessment of the risk retention solution that has been proposed by others that have preceded you in these hearings?

What bothers you about that?

Mr. **Eubanks**. It has not had widespread use when it was products liability. When you open it up to general liability, then I question the lack of guaranty fund coverage that it would not have in the State of Arkansas.

My lack of control over agency licensing and training, the misrepresentation of benefits or terms, I would have no control over; discrimination, a deposit for default of judgments in our State that I could directly attach, fraudulent forms, claims payments, proper reserves, proper rates. If this is going to be a Federal solution, I would hope that when it comes home to roost that it is still a Federal solution and the States don't have any part of it, because I do think in 3 to 5 years if it is widely accepted it could be a Frankenstein monster.

Mr. **Anthony**. Thank you very much.

Thank you, Mr. Chairman.

Chairman **Pickle**. Mr. Merrill, I have been reading your testimony in more detail, and I am amazed at the number of instances throughout your part of the country where you give example after example where you had insurance and had to drop it because of the cost. I have to assume there are a lot of towns that, because of what is happening, simply don't have any insurance or can't afford it.

Could you estimate how many towns or townships do not have any insurance now?

Mr. **Merrill**. I understand the problem is greater in those States which do not allow or do not provide for the formation of a captive or a pool. In those States, it is significantly higher than it is in the State of Michigan.

Under Michigan law local units of government are allowed to form pools which have become more popular in the last 9 or 10 months, but most units of government would much prefer conventional insurance.

We now have three pools that are being aggressively marketed to local units of government. One was just informed 2 weeks ago their reinsurance has been canceled, so that pool will probably go out of business. The other two pools—their portfolio is extensively offshore companies, companies unrated by Best and Horrels. According to the conventional insurance industry these are significantly underfunded, but they are where our members are going for—at least on paper—that type of coverage.

Chairman PICKLE. Well, if you can pool your policies, you might stay in operation. You point out in your testimony that a private business has the choice of meeting the increase in premiums or ultimately just going out of the business. But as a city and township, you don't have the privilege of going out of business.

Mr. MERRILL. That is correct.

Chairman PICKLE. You cannot go bankrupt.

Mr. MERRILL. Correct.

Chairman PICKLE. Your only alternative, then, is by some kind of pooling method.

Is that working or helping, or can you tell yet?

Mr. MERRILL. It is impossible to tell, because I am sure someone has testified here the long tail of liability claims. Most of these pools have only been up and running—the biggest ones just started last April. The other two are less than 2 years old. There have not been a significant number of claims going through the entire litigation process.

We would be very concerned, though, that one or two substantial lawsuits sustained against a pool member would probably put those pools right out of business.

Chairman PICKLE. When you hold these town hall meetings, who comes to them? What kind of representative groups do you have showing up?

Mr. MERRILL. From the citizenry?

Chairman PICKLE. Yes.

Mr. MERRILL. Generally, the people who have a beef against their township officials.

Chairman PICKLE. Do other cities involved come and join in with you, or is the town meeting just for that particular town?

Mr. MERRILL. Generally town meetings are specifically for that jurisdiction, that unit of government.

Chairman PICKLE. As I understand, the National Association of Town and Townships asked for an investigation into the insurance problem, and in January you facilitated the first meeting of the representatives of local and State governments.

How many people came to that meeting?

Mr. MERRILL. I don't recall. It seems there were in excess of 35 or 40, but I am not sure exactly. I wasn't at that meeting.

Chairman PICKLE. Well, that indicates that your problem is similar to all the other cities and townships in the country.

Mr. MERRILL. Without a doubt.

Chairman PICKLE. So, if you have another meeting that number will probably be enlarged, will it not?

Mr. MERRILL. If the invitation were extended to all of our members, we would have a great number of people there. But this was specifically representatives of different interest groups.

Chairman PICKLE. What would you recommend this committee do, or the Federal Government? What should be done?

Mr. MERRILL. Primarily what we would look at, if it is within the committee's—Congress'—power, is to make insurance more available. That would be wonderful. Whether that is a role you choose to take is a little bit beyond our immediate objectives.

Primarily, we are looking at some areas of Federal law, primarily section 1983 where there has been such an explosion of exposure to local units of government. And in the area of environmental impairment or pollution—which is also primarily Federal—action where we would seek to have some degree of indemnification, so the insurance industry can accurately assess what the risks are to their clients when they choose to insure local units of government, and perhaps we can get back on some more reasonable premium levels.

Chairman PICKLE. I know that you said that when the section 1983 originally started it was a human rights issue that occurred right after the Civil War. Then, for the first 100 years or more, there were about 200 suits filed under this particular section; however, in the last year alone there have been 24,000 suits filed.

Mr. MERRILL. Nationwide, right.

Chairman PICKLE. Well, it is obvious that this is a serious problem for communities; it is not just limited to individuals. And we appreciate your testimony and your statement.

Yes, Mr. Eubanks?

Mr. EUBANKS. Mr. Chairman, in Arkansas I believe in 1969, we instituted sovereign immunity for all cities, counties, and political subdivisions.

Chairman PICKLE. How did you do that?

Mr. EUBANKS. Through State legislation. Many States are now enacting caps of liability for their officials. We have the ultimate in tort reform in that you can't sue us. That has not stopped counties from purchasing insurance. They did that as an accommodation to the citizens.

Their renewal premiums now are 600 and 700 percent. And I have suggested to them that if they cannot afford it, they should not buy.

We have an Arkansas statute, 17-4007, which allows interlocal agreements, which basically says if you can buy it on your own, you can buy it as a group. Many have formed self-insurance groups for their automobiles, for their health insurance, and aimed specifically at the section 1983 they have a legal defense fund that they obligate a certain percentage of the total fund for any one claim. That has worked extremely well in our State.

Mr. ANTHONY. Mr. Chairman, would you yield?

Chairman PICKLE. Yes, Mr. Anthony.

Mr. ANTHONY. Mr. Eubanks, since Arkansas stands out there as an exception with three other States, as far as passing immunity statutes for government officials, what has been its history in the court system? Has that statute been challenged? Has it been upheld?

Mr. EUBANKS. It has been challenged repeatedly, and all you have to do now is walk into court, file a demurrer, and it should be over.

There is some room for liability, and that is if you do not maintain our financial responsibility laws for your automobiles. If you don't have that, which is a very small amount, the courts have deemed you are self-insured, and you are liable for that.

Mr. ANTHONY. In Arkansas, that is just a $10,000 limit, isn't it?

Mr. EUBANKS. It is $25,000/$50,000/$15,000 now, bodily injury, the first two, and then property damage.

Mr. ANTHONY. On another front, you want the States to do the same thing, Mr. Eubanks; yet, we have heard some testimony that says that the States do not have the professional capacity to do as thorough a job as they would like to see done.

One instance, it was shown where we have to pay a premium tax to go into the funding of the insurance personnel, and yet State legislature ratholes that money for some other function.

Knowing you probably haven't been in all 50 of these States but you do get some feedback from the National Association of State Commissioners, is there an area there that could and should be beefed up in order to do a better insurance oversight in the future?

Mr. EUBANKS. I would certainly love a larger budget. I have 90 employees now, and I am authorized 20 more that I can't afford to hire because I am funded through our State treasury. We brought in approximately $48 million 2 weeks ago to the State treasury, and I will receive around $2 million of that for my budget.

You find that many States, such as Arkansas, ride some fairly large coattails—Texas, California, Florida—and that we rely on the States whose staffs are sometimes six and seven times the size of my own who have the funding, who have the dedicated funding, and in that respect approximately 75 percent of the National Association of Insurance Commissioners model laws have been adopted in Arkansas.

We rode their coattails, quite frankly, and were tickled to death to do it. But there is no way that someone other than myself can respond to a claimant in Mountain Home or Oak Grove, Wing, Tomato, Montrose—that is not part of State government—not in the way I think you would want us to respond.

Mr. ANTHONY. Mr. Chairman, I thank you.

I would just like to close by a special thanks to Mr. Eubanks for coming up here from Arkansas. I don't know how the State is viewed in the industry as a whole, but I can say among the people who I do business with in the State we find that we have a very aggressive insurance overview and oversight, and we hopefully have an aggressive State legislature that can also help resolve some of these problems.

I do want to thank you for coming up and assisting us.

Mr. EUBANKS. Thank you, sir.

Chairman PICKLE. Mr. Eubanks, what happens in Arkansas, for example? A city or a township couldn't get insurance because of the premium cost or unavailability of it. So you eventually have passed an immunity statute in effect saying you are exempt.

Does this mean that an employee in Little Rock or Fayetteville who works on the streets or sewer lines, if they are injured, they simply won't have coverage except to the extent of workmen's compensation or something of that order?

Mr. EUBANKS. Workmen's comp would step in first in any sort of event.

Chairman PICKLE. I didn't understand you.

Mr. EUBANKS. Workmen's comp would step in first in any sort of event. They would be primary. What this means——

Chairman PICKLE. Other than that, their coverage is——

Mr. EUBANKS. In the past when someone sued the county for a slip and fall, say, it directly sued the insurance company if the county had purchased insurance. If the county has not, the county judge is empowered to set up a hearing process for claims and can hear claims and make a determination of benefits. Then the next step would be our State claims commission, which is a legislative body.

Chairman PICKLE. All right. We thank you gentlemen very much for your testimony.

Robert E. Barker is the executive director of the DePelchin Children's Center in Houston, TX, and you are testifing on behalf of the Child Welfare League of America.

Dr. Gwendolyn Calvert Baker is the executive director of the YWCA of the United States, National Board; and you are speaking on behalf of the National Assembly of National Voluntary Health and Social Welfare Organizations.

Linda Williams, director of programs, Community Day Care and Comprehensive Social Services Association, Memphis, TN.

Congressman Ford had hoped he might be here today and expressed his regret. We are glad to have you here, Ms. Williams.

Now we will ask Mr. Barker if you would proceed first.

STATEMENT OF ROBERT E. BARKER, EXECUTIVE DIRECTOR, DePELCHIN CHILDREN'S CENTER, HOUSTON, TX, ON BEHALF OF THE CHILD WELFARE LEAGUE OF AMERICA, INC.

Mr. BARKER. Mr. Chairman and members of the subcommittee, again my name is Robert E. Barker. In addition to being executive director of the DePelchin Children's Center in Houston, I am president of Texas Licensed Children's Agencies, and I am representing that association as well as the Child Welfare League of America.

I want to thank you for the opportunity to be here today to address some issues we think are important in terms of liability insurance issues.

The Child Welfare League of America is the only privately supported organization in the United States representing 24-hour care for children. We are an association of some 400 leading agencies nationwide and in Canada. An additional 1,200 affiliates in 27 States are part of the league. We are both private, not-for-profit, and governmental agencies. .

Most of the talk regarding the impact of liability insurance and child care has related to the problems that the day care industry has had in obtaining liability insurance coverage. The issues I want to address affect the agency's associations across this country to provide 24-hour care, the agency's residential treatment centers, group homes, child placement agencies that handle adoption and foster care of children.

Our agency is one such agency, the DePelchin Children's Center, providing psychiatric treatment, residential care, adoption, residential maternity care services, and the like.

Children who come to the agencies in the association of the Child Welfare League of America come for a variety of reasons. Many have been abused and neglected. Many are placed by courts because of abuse, neglect. Some are placed voluntarily by their parents because of either major family problems the family has or because children are in some cases emotionally disturbed to the extent that they need treatment and care out of their own home on a 24-hour care basis.

Some come from the judicial system where they have been removed from their own homes because of delinquency behavior. But these are children, by and large, who are in care for circumstances beyond their control.

Some of the funding for these children is Federal in nature. Federal Title IV-E, foster care funding, adoption assistance funding, title XX, social services block grant funding, are some of the sources of funding for these very vulnerable children.

Generally, in the day care industry, day care field, when the cost of liability insurance goes up, those costs are simply passed on to parents who primarily are the payors of the service. This really doesn't apply to the children who are cared for in 24-hour facilities, particularly those who are removed from their own homes because of abuse and neglect.

If they are cared for by not-for-profit agencies and insurance premiums simply skyrocket, there is no place to pass these costs on. You can't pass them on to the owners of the corporation and simply reduce the profit, but these costs simply are added to the cost of care. With Federal and State cutbacks in terms of funding for children's services, there is no place to pick up the slack when these costs go up.

In some situations, when agencies have their policies canceled, State licensing requirements, and sometimes contractual relationships with public agencies that purchase service for private agencies in which an agency is required by law to maintain liability insurance, an agency may cease to be able to operate because they cannot obtain or maintain insurance coverage.

Our agency, the DePelchin Children's Center in Houston, is 90 years old. During that period of time, there has never been a claim adjudicated against the agency in terms of liability coverage. Yet, in 1 year, this current year, our combined costs for liability insurance, which covers directors' and officers' liability, professional malpractice coverage and a general umbrella liability policy went from $36,000 in 1 year to $75,000 in 1 year in premiums.

The American Association of Children's Residential Centers, which supports our position, and the position of the Child Welfare League, reports one of its member agencies in Evergreen, CO, a 32-year-old facility which has never had a claim against it, was notified on February 25th of this last month that its liability coverage would be cancelled effective March 25. They are required under Colorado State law to have liability insurance in order to operate, so they are in a scramble trying to obtain coverage or being forced to shut their doors on March 25.

In Cleveland, OH, 20 agencies out of 70 funded by the United Way in that community have been informed that their liability insurance coverage will cancel effective April 1, 1986.

In Texas, there have been six agencies in the last year that have ceased providing residential care because of loss of liability coverage. One emergency shelter in Houston closed their shelter component 6 months ago because they could not obtain directors' and officers' liability coverage.

In Arizona, eight agencies are gone in 1 year due to the inability to obtain renewals of their liability coverage.

The costs have gone up—in Texas by 150 percent in 1 year in terms of premiums; in Arizona, 550 percent; in New York, 200 percent; in Illinois, 150 percent—in terms of just 1 year, in terms of premium increases.

I would like to point out that our agencies are not underregulated or not operating in the dark without inspections. We are, for example, accredited by two national groups, very regular accreditation visits.

Our relicensing authorities in our States see us six times a year. We have site visits from fire and health marshals, United Way panels, because we receive some United Way funding. We are a very regulated, inspected industry.

We think there are some heavy issues that are going to impact the survival of the not-for-profit, 24-hour care, the backbone of providing services to our abused, neglected children.

Let me point out one of them. I think it is important in terms of how it threatens the spirit of voluntarism in our country. Most board members who serve as board members of not-for-profit organizations in our communities are people who are committed to a community and committed to helping the life in a community be better. They are not interested in serving if they can't obtain directors' and officers' liability coverage, and their own personal assets become at risk of being tapped into if there is some judgment that is brought against the agency, and then eventually brought against their own assets.

If board members are asked to serve as board members without the ability to have directors' and officers' liability coverage, we are going to see an important group in our society, those who commit time without reimbursement, to cease providing that kind of community service.

Our agencies are being squeezed from the top to the bottom. As the impact of the Gramm-Rudman cuts begin coming down and fewer dollars being available to provide care, with the insurance costs going up the squeeze is going to make it difficult for services to be provided.

The crisis, to us, appears to be the result, as far as we are concerned in the 24-hour care, the result of a misunderstanding on the part of the insurance industry concerning the risks in 24-hour care of children. The losses, based on a survey of the Child Welfare League of America of its members, have been very minimal. There have been very, very few claims in our field adjudicated against our agencies. But there is an assumption that it is a high risk area because you are taking care of troubled children in institutions or foster homes or adoptive placements, and therefore many carriers are choosing not to write this coverage, and the claims or the premiums are going up at a rapid rate.

We think there is——

Chairman **Pickle**. Where did that assumption come from? Who makes the assumption that it is high risk?

Mr. **Barker**. I think there is association with the fact you are taking care of children, and the industry fears when you do have a judgment it is going to be a mammoth judgment whether you have one or not. So, the assumption is there ahead of time, I believe, that the claims are going to be mammoth claims.

Chairman **Pickle**. Have you had suits brought against you?

Mr. **Barker**. Never have. But our premium went up 110 percent this year based not on any experience we had, but based on industry standards and industry judgment.

Chairman **Pickle**. Let me ask, could we have a cessation of your testimony because of the time limit, and go to the next person? We will come back for any comment you want to make, Mr. Barker.

[The prepared statement follows:]

STATEMENT OF ROBERT E. BARKER, EXECUTIVE DIRECTOR, DEPELCHIN CHILDREN'S CENTER, HOUSTON, TX, ON BEHALF OF THE CHILD WELFARE LEAGUE OF AMERICA, INC.

Mr. Chairman and members of the Subcommittee, my name is Robert E. Barker and I am Executive Director of the DePelchin Children's Center in Houston, Texas. This morning, I am pleased to represent the Child Welfare League of America and wish to thank you, on behalf of the League, for the opportunity to testify regarding what can now truly be referred to as the crisis of liability insurance coverage.

The Child Welfare League (CWLA) is the only privately supported organization in North America solely devoted to improving services for deprived, neglected, and abused children. We are an association of some 400 leding child welfare agencies in the United States and Canada, with an additional 1200 affiliates in 27 state associations. We include voluntary and public; religious and non-sectarian agencies. As an example, among our members are the Children's Bureau of South Carolina and the Porter-Leath Children's Center in Memphis, Tennessee.

I suspect by now everyone is aware that liability insurance coverage is a problem. It is currently affecting doctors, city governments, architects, bartenders, truck drivers and engineers. I am here, representing the interests and participation of CWLA, to suggests that with regard to children, it is indeed a crisis.

Most of the talk regarding the impact of liability insurance and children has centered on day care. I want to talk to you this morning about its crushing effect on a smaller, but much more vulnerable group of children—those housed in group homes and residential care facilities. My agency, the DePelchin Children's Center, is such a facility.

Who are these children? They come to us for a variety of reasons but they have one thing in common—they have had to be removed from their natural homes. About half, according to a recent report by the U.S. Department of Health and Human Services (HHS), are victims of abuse or neglect. Another 25 percent have parents who are deceased, suffering prolonged illness, or severely handicapped. All of these children are out of their homes due to a traumatic experience beyond their control. Most of the remainder suffer from some emotional disturbance or have been referred from the juvenile justice system.

A portion of the care provided to a large number of these children comes from the Federal Title IV-E Foster Care Program. In addition, the majority of CWLA agencies receive funds from Title XX Social Services Block Grant which helps to provide counseling and needed support services.

Parents of children in day care have to pay more when insurance goes up. They will suffer; and the children of those who cannot afford the increased cost will suffer. But at least they have homes and families. Our children have no home beyond that provided by our facilities.

Our agencies are either public or private, non-profit. When insurance costs double or triple, it does not cut in to our profit margin. We have none. When cost goes up beyond our ability to pay, we lose our insurance. When we lose our insurance or it is cancelled—if we cannot replace it—we close. Our children—among jour society's most vulnerable—the abandoned, the abused, the hurt—suffer again. That is why I use the term "crisis" without hesitation.

What does the crisis look like when you are on the receiving end? My agency in Houston is 90 years old. In that 90 years, we have not had a single claim adjudicated against us. I have just received word that the insurance bill for my agency will jump from $36,000 to $75,000 a year—a 110 percent increase in one year's time.

The American Association of Children's Residential Centers (AACRC), which supports our positions, reports that one of its member agencies in Evergreen, Colorado—a 32-year-old facility which has never had a claim against it—was notified on February 25th that its policy would be cancelled in thirty days. The state of Colorado does not allow residential child care facilities to operate without insurance and the facility in Evergreen is now deciding whether to announce that it is closing on March 25th. They take care of severly emotionally disturbed youngsters.

Many group homes and residential child care facilities have already closed. In Texas, where insurance rates across the State are up 100–150 percent, six agencies have closed. In Arizona, where insurance rates across the state are up 550 percent, eight agencies are gone.

Our agencies are not fly-by-night. My own agency has licensing visits from the state on an average of once every 60 days; accreditation renewal visits once every three years; and United Way site visits twice a year. We must meet the highest professional staff standards and abide by all state and local health and code safety requirements. Since we deal with children-at-risk, we are among the most licensed, monitored, and regulated facilities in the country. We therefore find ourselves in double—and sometimes triple—binds when it comes to insurance. In the state of Texas, and in many other states, without insurance you cannot have a state license; and without a state license you don't operate.

To qualify as a private, non-profit entity and be licensed by many States, our agencies must have Boards of Directors. The Directors are themselves liable if the agency is sued and many are now dropping from participation because they cannot face the risk if their agency's insurance is cancelled. One shelter program in Houston recently closed down altogether because they could not obtain affordable Direector's and Officers' liability insurance for the Board.

Then there is the issue of automobile insurance. In Arizona, one insurance company dictated that they would *only* cover trips to and from the doctor's office. Another agency said they were told that they could get their bus covered but not their automobiles and the bus was only covered if the driver was the agency psychologist or its Executive Director—not child care workers. If one child needs to go to the doctor, were they supposed to load that one child on the bus with the psychologist? Yet, a residential facility canot operate without transportation and it cannot have transportation without insurance.

These horror stories are not limited to the Southwest. In New York, a survey of 49 agencies revealed that three had their coverage cancelled outright—no warning, no waiting period. Average increases in premiums are up 50 percent. In Illinois, rates are up 150 percent throughout the state. In Minnesota, they are up 300 percent.

Our agencies are being squeezed from the top and bottom. Most receive assistance from the Title XX—Social Services Block Grant, which has been frozen for the last five years, and from Title IV-E Foster Care Assistance, which will be frozen by Gramm-Rudman. With Federal assistance falling behind inflation and in some cases being cut, less public money is available to help us maintain operational expenses at the very time that the insurance industry is doubling and tripling those expenses. The losers are the kids—most of whom have already suffered losses that most of us will never encounter. As always, those from low-income backgrounds will be hit the hardest.

Those of us who can stay open will have to look for children covered by private, third-party payments—usually the children of middle and upper income families. Public reimbursement usually covers only about 75% of expenses and as expenses go up, fueled by insurance costs, the gap will widen beyond our ability to pay. Children from families with private insurance will get priority. Children without families and children from low-income families will either go unserved or be warehoused in large state-run institutions. If state governments lose coverage—as some city governments have done and as may now be happening to the State of Colorado—I don't know what will happen.

I am not ready to say that the insurance industry has purposefully cooperated in raising these rates to crisis proportions. I am ready to say, on behalf of CWLA, that our nation's most vulnerable children are being held hostage by that crisis.

What can be done? The Child Welfare League of America suggests these alternatives:

At a minumum, the Federal government should be authorized to monitor the insurance industry to assure that group homes and residential child care facilities are provided liability insurance in a fair, equitable manner.

Secondly, the insurance industry should be required by the Federal Government to provide affordable coverage to group homes and residential child care facilities.

If these recommendations are not sufficient or are unobtainalble:

CWLA recommends that the Federal government establish Federal insurance coverage to group homes and residential child care facilities, perhaps in the same manner that it provides flood insurance to areas of farm land particularly vulnerable to flooding. Such insurance shoul have little if any ultimate cost to the Federal Government; if our past claims records continue to hold true, it might even provide a surplus. Such insurance would be treating children most at-risk as if they were indeed an endangered national resource.

The insurance industry should not protest since, if its cancellations of our agencies are an indication, they are not able to afford our business anyway.

If we do not address the crisis in a timely fashion, I fear that the next time I appear before you, it will be to ask where you want us to deliver the children we once served.

Chairman PICKLE. Dr. Baker, would you proceed?

STATEMENT OF GWENDOLYN CALVERT BAKER, EXECUTIVE DIRECTOR, YWCA OF THE U.S.A., NATIONAL BOARD, AND MEMBER OF THE BOARD OF THE NATIONAL ASSEMBLY OF NATIONAL VOLUNTARY HEALTH AND SOCIAL WELFARE ORGANIZATIONS

Ms. BAKER. Thank you.

Mr. Chairman, it is a great pleasure for me to accept your invitation to testify here today on an issue of critical importance to the future of voluntary health and social welfare organizations—liability insurance, its cost, availability, and impact on services to individuals and families in our Nation.

My name is Gwendolyn Calvert Baker, executive director of the YWCA of the U.S.A., national board. I am appearing on behalf of the National Assembly of National Voluntary Health & Social Welfare Organizations, a coalition composed of 29 national voluntary health and social welfare agencies representing local service providers in every community in the Nation. Our national agencies collectively reach over 50 million people each year, serving a diverse cross-section of our Nation's population, from rural to urban areas, from all income levels, including AFDC recipients, and from all ethnic, racial, religious, and social backgrounds.

Some of the services we provide are dependent care for children and the elderly, counseling and support services for youth, adults, and families, and social and health services for those with special needs and/or limited resources.

Over the past 6 months, the national assembly has been deluged with calls from members expressing concern about the problems they and their affiliates are having in obtaining and retaining liability insurance coverage at affordable rates. The types of insurance which seem to be at issue include general liability, directors' and officers' liability, automobile and professional liability.

In many instances, agencies' coverages are being reduced. They face exorbitant increases in premiums; they are unable to renew their coverage; and policies currently in force are being canceled outright. The problems faced by agencies, therefore, are higher premiums, higher deductibles and copayments, lower coverage and shorter policy terms.

It appears that there is no relationship between an organization's claims history and its ability to obtain coverage or affordable premium rates. The same is true between risk management efforts to protect an agency's directors, officers, staff, volunteers, and consumers/participants, and rates. Coverage problems seem to exist throughout the health and social welfare sector.

The traditional strength of the voluntary nonprofit agency has been its effort to involve its community in policymaking, utilizing local community volunteer leadership on its boards to assess needs, and plan and evaluate programs. This involvement has translated into "community ownership" of a program and has helped agencies to respond to the specific needs of the community it serves. We face a loss in "community ownership" as individuals become understandably reluctant to serve as a director or officer.

As an ironic note, in the midst of its work on this issue, the national assembly itself received notice that its directors' and officers' liability insurance was being canceled 1 year before the 3-year policy was due to expire. In its preliminary search for coverage, the national assembly was offered a policy for one-third the coverage at six times the premium previously paid.

In response to its members' concerns, the national assembly appointed a special insurance committee, of which I am a member, which quickly moved ahead simultaneously to offer direct assistance to members wanting to explore alternatives available to meet their immediate crises and to gather more information about potential joint activity. Because of the complex nature of insurance, the State-by-State variations in laws, and the differences in risk amongst its members, it may be difficult for the national assembly to establish a common self-insurance program; however, all options will be explored.

Issues of legal liability, risk financing, and risk control in the nonprofit world will be addressed. It should be noted that there is much activity on the State level where member affiliates are testifying at insurance commission hearings, participating in meetings with representatives of the insurance industry, attending educational forums on the issue, and exploring possible legislative reform proposals.

The crises in insuring health and social welfare agencies is almost reaching a point where the actions of the insurance industry could dictate the types and continuity of programs that are offered by an agency, especially in States where liability insurance is required to provide certain direct services to consumers.

The following are only a few examples of situations being faced by national assembly member agencies: The YWCA of the U.S.A.'s national headquarters has heard from YWCA's from every part of the country. Even if affiliates have had no claims, as the El Paso, TX, YWCA, and good safety records, companies are refusing to cover such areas as team sports competition, camps, gymnastics, shelters for victims of domestic violence, and child care programs.

Many YWCA affiliates are dealing with 300 to 500 percent increases in premiums. Rates rose for the Minneapolis, MN, YWCA from $30,000 to $100,000 in 1 year; from $12,000 to $64,000 for El

Paso for less coverage; from $57,000 to $250,000 for New York City for half coverage; and from $2,600 to $85,000 for the Oakland, CA, YWCA.

United Way of America, with 2,400 affiliates in the United States, has been receiving many responses to its recent survey on liability insurance for nonprofits. They report in Texas, where a settlement house program's general liability insurance got canceled suddenly and they had to close their doors for 3 weeks.

In one Pennsylvania community, the local United Way found premium increases from zero to 685 percent, with a net increase among its member agencies of 79 percent.

Agencies with recreational services and those serving youth appeared to be affected the most. The experience is similar according to reports by several United Ways in New York where one affiliate also reported that a day care program for the elderly could not be opened because the agency was unable to get the program covered under its umbrella liability package. In this instance, the insurance problem directly resulted in prohibiting the delivery of a much-needed community service.

In another situation, a child care program's malpractice insurance increased and then was canceled within 6 months, and because they have not found a carrier to insure them at any price, they are operating without coverage. The same agency's directors' and officers' insurance cost has also increased, from $630 to $21,000, even if they have had no history of claims.

One United Way reported on a survey conducted by the Department of Human Services in the State of New Jersey of 237 child care centers. Seventy-three percent stated they had experienced increases in premium costs from a prior year average of $2,388 to $4,135.

Camp Fire, Inc., has reported that its camping programs are being seriously affected by the insurance crises. For example, the Minneapolis Council of Camp Fire recently wrote the members of the Minnesota State Legislature to share that their horse program was cut because they could not afford to pay the insurance costs of having horses at camp. The cost for coverage alone would have been $18,000 for 4 weeks.

Insurance for the bus used for the council's day camp program's wilderness experience will cost $180 per day. The cost last year was $70.

The Boys Club of Fort Worth, TX recently received a notice 1 month before the expiration date of their general liability insurance that their insurance carrier would not renew their policy. After searching extensively for a new carrier, with no results, 2 days before the expiration date of their policy they went to their daily newspaper to announce to the community that they would be closing their program unless a carrier was found.

On the day before the expiration of the policy, they found a carrier for a 400-percent increase in insurance premium. To meet the increased expense of their insurance, they had to conduct an immediate special fund-raising effort so that the program staff and services would not be cut.

The insurance crisis is real to voluntary health and social welfare agencies. It is decimating cash flow, forcing cutbacks in staffing, reducing services to individuals and families, creating budget deficits, and deferring needed purchases of program equipment and supplies. Local boards are being faced with heart-wrenching decisions in curtailing or reducing programs, raising fees, using operational reserves, and deferring hiring.

If the increased insurance costs were to be passed along to the families that benefit from our programs, those with limited financial resources could not participate. Our agencies are committed to providing quality affordable services to individuals and families. If the rising insurance costs and cancellations continue, child care services for working parents—before and after school, as well as summer programs—could be reduced throughout the country or become unavailable, particularly to low income families, because of increased fees, less slots, a closure of a program.

Needed new programs, such as day care for the elderly, identified by community leaders, may never open and the need will go unmet. Recreational services and life skills development programs for our Nation's youth could be curtailed, programs that seek to prevent delinquency and are crucial to youth becoming productive adults.

With the potential loss of voluntary leadership and fewer services to fewer individuals and families, communities will suffer. Not only will the voluntary organizations be affected, but the needs of millions of children, youth, elderly, disabled and the poor will go unmet.

The national assembly remains committed to seek a resolution to this critical and complex problem. We stand ready to be of service to this subcommittee in any way.

[The prepared statement follows:]

Statement of the National Assembly of National Voluntary Health and Social Welfare Organizations, Presented by Gwendolyn Calvert Baker, Executive Director, YWCA of the U.S.A., National Board, and Member of the Board of the National Assembly

Mr. Chairman, it is a great pleasure for me to accept your invitation to testify here today on an issue of critical importance to the future of voluntary health and social welfare organizations — liability insurance, its cost, availability and impact on services to individuals and families in our nation.

My name is Gwendolyn Calvert Baker, Executive Director of the YWCA of the U.S.A., National Board. This afternoon, I am appearing on behalf of the National Assembly of National Voluntary Health and social Welfare Organizations. The National Assembly is composed of 29 national voluntary health and social welfare agencies representing local service providers in every community in the nation. Our national agencies collectively reach over fifty million people each year - serving a diverse cross-section of our nation's population from rural to urban areas, from all income levels, including AFDC recipients, and from all ethnic, racial, religious, and social backgrounds. Some of the services we provide are dependent care for children and the elderly, counseling and support services for youth, adult, and families, and social and health services for those with special needs and/or limited resources, programs and consumers that are within the jurisdiction of the Committee on Ways and Means. (Attached is a list of National Assembly member agencies).

The National Assembly strives to provide opportunities for the continuing development of knowledge, skills and values needed to effectively lead and manage voluntary national human service organizations and to promote the development and implementation of sound public policies, programs, and resources that are responsive to the needs of human service organizations and those they serve.

We appreciate the opportunity to share with you our great concerns over the escalating liability insurance crisis, which could not come at a worse time when voluntary, non-profit, health and social welfare organizations are bearing the strains of major cutbacks in federal funding, the ever-increasing demand for services in our local communities, and the prospect of decreased charitable giving due to potential changes in the tax code.

Over the past six months, the National Assembly has been deluged with calls from members expressing concern about the problems they and their affiliates are having in obtaining and retaining liability insurance coverage at affordable rates. The types of insurance which seem to be at issue include general liability, directors and officers liability, automobile and professional liability. In many instances, agencies' coverages are being reduced, they face exorbitant increases in premiums, they are unable to renew their coverage, and policies currently in force are being canceled outright.

The problems faced by agencies, therefore, are higher premiums, higher deductibles and co-payments, lower coverage and shorter policy terms. It appears that there is no relationship between an organization's claims history and it's ability to obtain coverage or affordable premium rates. The same is true between risk management efforts to protect an agency's directors, officers, staff, volunteers, and consumers/participants, and rates. Coverage problems seem to exist throughout the health and social welfare sector, although those who appear to be more affected are agencies which offer direct service, and particularly those who serve young people.

The sense of urgency to address this situation becomes even more critical as an increasing number of voluntary agencies are unable to obtain or retain their directors and officers (D&O) liability insurance. This insurance protects the personal assets of directors and officers against wrongful action claims. The traditional strength of the voluntary non-profit agency has been its effort to involve its community in policymaking, utilizing local community volunteer leadership on its boards to assess needs, and plan and evaluate programs. This involvement has translated into "community ownership" of a program and has helped agencies to respond to the specific needs of the community it serves.

We face a loss in "community ownership" as individuals become understandably reluctant to serve as a director or officer. (As an ironic note, in the midst of its work on this issue, the National Assembly itself received notice that its directors and officers liability insurance was being cancelled one year before the three-year policy was due to expire; in its preliminary search for coverage, the National Assembly was offered a policy for *one-third* the coverage at *six times* the premium previously paid).

In response to its members concerns, the National Assembly appointed a special insurance committe, of which I am a member, which quickly moved ahead simultaneously to offer direct assistance to members wanting to explore alternatives available to meet their immediate crises and to gather more information about potential joint activity. Because of the complex nature of insurance, the state-by-state variations in laws, and the differences in risk amongst its members, it may be difficult for the National Assembly to establish a common self-insurance program, however, all options will be explored. Issues of legal liability, risk financing, and risk control in the non-profit world will be addressed. It should be noted that there is much activity on the state level where member affiliates are testifying at insurance commission hearings, participating in meetings with representatives of the insurance industry, attending educational forums on the issue, and exploring possible legislative reform proposals.

The crises in insuring health and social welfare agencies is almost reaching a point where the actions of the insurance industry could dictate the types and continuity of programs that are offered by an agency, especially in states where liability insurance is required to provide certain direct services to consumers. The following are only a few examples of situations being faced by National Assembly member agencies:

The *YWCA of the USA's* National headquarters has heard from YWCAs from every part of the country. Even if affiliates have had no claims, as the El Paso, Texas, YWCA, and good safety records, companies are refusing to cover such areas as team sports competition, camps, gymnastics, shelters for victims of domestic violence, and child care programs. Many YWCA affiliates are dealing with 300 percent to 500 percent increases in premiums. Rates rose for the Minneapolis, Minnesota, YWCA from $30,000 to $100,000 in one year; from $12,000 to $64,000 for El Paso for less coverage; from $57,000 to $250,000 for New York City for half coverage, and from $2,600 to $85,000 for the Oakland, California YWCA. Several YWCAs closed down temporarily (in Boulder, Colorado, for one week) as they frantically looked for coverage. One affiliate staved off bankruptcy by receiving coverage under the policy of another YWCA in the same metropolitan area. This coverage is only for one year but it is enabling the doors to be kept open while that YWCA explores other options.

United Way of America, with 2,400 affiliates in the United States, has been receiving many responses to its recent survey on liability insurance for non-profits. They report in Texas, where a settlement house program's general liability insurance got cancelled suddenly and they had to close their doors for three weeks. Another building centered multi-services agency's general liability premium rose from $60,000 to $460,000 in one year, its umbrella liability rate $45,000 to $350,000 and its coverage decreased from $30 million to $10 million. In California, a survey in one city revealed that 90% of the United Way's member agencies responding had or anticipated an increase in the cost of their insurance 100 percent to 300 percent, or an average increase of $9,000, with one agency anticipating a possible increase of $170,000. In one Pennsylvania community, the local United Way found premium increases from 0 percent—685 percent with a net increase among its member agencies of 79 percent.

Agencies with recreational services and those serving youth appeared to be affected the most. The experience is similar according to reports by several United Ways in New York where one affiliate also reported that a day care program for the elderly could not be opened because the agency was unable to get the program covered under its umbrella liability package. In this instance the insurance problem directly resulted in prohibiting the delivery of a much needed community service.

In another situation, a child care program's malpractice insurance increased and then was cancelled within six months, and because they have not found a carrier to insure them at any price, they are operating without coverage. The same agency's directors and officers insurance cost has also ncreased from $630 to $21,000 even if they have had no history of claims. One United Way reported on a survey conducted by the Department of Human Services in the State of New Jersey of 237 child care centers; 73 percent stated they had experienced increases in premium costs from a prior year average of $2,388 to $4,135. Out of 199 centers, 17 percent received cancellations, 6 percent the insurer reduced coverage, and 1 percent chose to reduce coverage probably to reduce their premium burden; 7 out of 202 centers reported claims. Out of the claims settled, the monetary award did not exceed $310 and none was attributable to child abuse or neglect.

The *Denver, Colorado, Girls Club* has had its general liability and directors and officers insurance cancelled with less than a week's notice.

Camp Fire, Inc. has reported that its camping programs are being seriously affected by the insurance crises. For example, the Minneapolis Concil of Camp Fire recently wrote the members of the Minnesota State Legislature to share that their horse program was cut because they could not afford to pay the insurance costs of having horses at camp. The cost for coverage alone would have been $18,000 for 4 weeks. Insurance for the bus used for the Council's day camp program's wilderness experience will cost $180 per day. The cost last year was $70.00. This means that campers will need to pay double what they paid last year and the Council is deeply concerned that the fees may be prohibitive for some families.

The Boys Club of Fort Worth, Texas recently received a notice one month before the expiration date of their general liability insurance that their insurance carrier would not renew their policy. After searching extensively for a new carrier with no results, two days before the expiration date of their policy they went to their daily newspaper to announce to the community that they would be closing their program unless a carrier was found. On the day before the expiration of the policy, they found a carrier for a 400% increase in insurance premium. To meet the increased expense of their insurance, they had to conduct an immediate special fund raising effort so that the program staff and services would not be cut. Boys' Clubs of America is currently conducting a survey to assess the insurance crises' impact on Boys Clubs accross the country.

The insurance crisis is real to voluntary health and social welfare agencies. It is decimating cash flow, forcing cutbacks in staffing, reducing services to individuals and families, creating budget deficits, and deffering needed purchases of program equipment and supplies. Local boards are being faced with heart-wrenching decisions in curtailing or reducing programs, raising fees, using operational reserves, and deferring hiring. If the increased insurance costs were to be passed along to the families that benefit from our programs, those with limited financial resources could not participate.

Our agencies are committed to providing quality affordable services to individuals and families. If the rising insurance costs and cancellations continue, child care services for working parents - before and after school, as well as summer programs - could be reduced throughout the country or become, unavailable, particularly to low-income families because of increased fees, less slots, a closure of a program. Needed new programs, such as day care for the elderly, identified by community leaders, may never open and the need will go unmet. Recreational services and life skills development programs for our nation's youth could be curtailed, programs that seek to prevent delinquency and are crucial to youth becoming productive adults.

With the potential loss of voluntary leadership and fewer services to fewer individuals and families, communities will suffer. Not only will the voluntary organizations be affected but the needs of millions of children, youth, elderly, disabled and the poor will go unmet.

The National Assembly remains committed to seek a resolution to this critical and complex problem. We stand ready to be of service to this subcommittee in any way.

MEMBERS

AFL-CIO, Department of Community Services;
American Council for Nationalities Service;
American Foundation for the Blind;
American Red Cross;
The Association of Junior Leagues;
Big Brothers/Big Sisters of America;
Boy Scouts of America;
Boys Clubs of America;
Camp Fire;
Child Welfare League of America;
The Congressional Award;
Council of Jewish Federations;
Girl Scouts of the U.S.A.;
Girls Clubs of America;
Lutheran Council in the U.S.A., Division of Mission and Ministry;
National Committee for Adoption;
National Conference of Catholic Charities;
National Council of Negro Women;
The National Council on the Aging;
National HOmeCaring Council;
The National Network of Runaway and Youth Services;
The Salvation Army;
Travelers Aid Association of America;
United Neighborhood Centers of America;
United Seamen's Service;
USO (United Service Organizations);
United Way of America;
YWCA of the USA;
YWCA of the U.S.A., National Board.

Chairman PICKLE. Thank you, Dr. Baker.

Now, Linda Williams.

STATEMENT OF LINDA L. WILLIAMS, DIRECTOR OF PROGRAMS, COMMUNITY DAY CARE AND COMPREHENSIVE SOCIAL SERVICES ASSOCIATION, MEMPHIS, TN

Ms. WILLIAMS. Mr. Chairman, I am Linda Williams, director of programs for Community Day Care and Comprehensive Social Services.

The association has provided administrative and fiscal management services to private nonprofit social service programs in Memphis, TN for the past 15 years. The association itself is a private nonprofit corporation chartered and incorporated in the State of Tennessee to promote the general welfare of the citizenry through the coordinated management and provision of social services to families.

In the interest of assuring that the association subcontracted programs and grantor entities were adequately insured, the negotiation and procurement of insurance coverage for the program have been reserved and consolidated as the responsibility of the administrative management provided by community day care. This consolidation of property/casualty insurance procurement is only one aspect of the functions consolidated under the management auspices of the association.

The annual insurance premiums paid by the association prior to funding year 1986 were relatively fixed for three fiscal years. Therefore, we feel that the increases in the association's premium cost have illustrated a dramatic increase in certain insurance lines for day care providers throughout the marketplace.

In a comparison of the premiums paid by our organization, we have seen a 331 percent overall increase. Our more dramatic increases are in our liability coverage. The increase in community day care's liability insurance was seven times the cost for 1985, with a reduction in coverage. In 1985, our excess liability was $5 million, while the new premium rate affords us only $1 million in coverage.

Also, the company has stipulated that child sexual abuse claims are excluded. In the 15 years of Community Day Care's operation, we have had only two lawsuits. One involved a child who was not involved in any of our programs who climbed over a barbed wire fence around a swimming pool and drowned. This claim was settled out of court by the insurance carrier with a $10,000 settlement. The second suit involved a traffic accident involving a senior citizen. Even though a suit was filed, no damages or settlements were ever made.

The funds that Community Day Care had earmarked for purchases of major equipment and building improvements in 1984 were transferred to cover our increased insurance cost. We were unable to secure local dollars to cover the insurance increases, and no additional grant funds were available.

At this point, we do not know how we will be able to offset these increases in our next year's budget. As social service agencies such as ours are anticipating fiscal reductions under the Gramm-Rudman-Hollings Act, we are anticipating further reductions of our services due to the cost of our insurance. This impacts drastically on the current economy as 68 percent of the families that we serve are working or in training. Without these day care services, many of our clients will face a return to welfare rolls.

Not a day passes in which we do not receive calls from current day care providers or individuals seeking to establish new programs asking for information on how they can secure insurance coverage. Since we have been asked by our broker not to share the name of our carrier, due to the carrier's desire not to be bombarded with requests for similar coverage, we can offer little in response to those inquiries.

At a time in Memphis when the need for more day care services overshadows the current available market, the insurance crisis is presenting a major barrier for expansion of services. We contend that it is unfortunate that such large premiums are demanded to secure insurance. These dollars could be better utilized for the cost of services to the client families.

Even though we are currently reaching over 850 families in our day care programs, we have over 600 families still on our waiting list, and these individuals are all eligible for services.

In discussions with the staff of the State of Tennessee Department of Commerce and Insurance, we have inquired about joint underwriting or assigned risk pools and self-insuring coalitions as potential alternatives to this problem. It is our understanding that legislation would be required where the insurers are unwilling to voluntarily establish such alternatives. Should those alternatives be voluntarily established, and we still have the high premium cost, it will leave little for us to do other than reduce services.

We are talking about the closing of two to three day care programs involving 200 children.

In conclusion, we have found very few alternatives to suggest beyond some form of State or Federal intervention. Ultimately, legislation may be needed to set legal limits on liability in order to diffuse the volatile liability insurance premium hikes.

In the case of social service programs such as those of the association, which receive significant government financial participation and serve low income and handicapped persons, we have no means to pass on the premium increases to our consumers.

Lastly, if the crisis persists or increases, and we would suggest that Congress pass a liability program similar to the Federal flood and crop insurance programs to assure the protection of human service agencies.

We would like to thank you for your interest in this matter.

[The prepared statement follows:]

STATEMENT OF LINDA L. WILLIAMS, DIRECTOR OF PROGRAMS, COMMUNITY DAY CARE AND COMPREHENSIVE SOCIAL SERVICES ASSOCIATION

Mr. Chairman, members of the Committee Staff, Ladies and Gentlemen: Community Day Care & Comprehensive Social Services Association has provided administrative and fiscal management services to private, non-profit social services programs in Memphis, Tennessee, for the past fifteen years. The Association itself is a private non-profit corporation chartered and incorporated in the State of Tennessee to promote the general welfare of the citizenry through the coordinated management and provision of social services to individuals, children and families.

CDC&CSSA has, for the past fifteen years, held contracts with the Tennessee Department of Human Services, the City of Memphis, and Shelby County in addition to various other entities of the State and Federal government. Through Social Service Block Grant funding, CDC&CSSA offers day care services for 838 preschool age children at 13 locations. An additional 75 children are served in Family Day Homes. An after school program for school age children serves 140 children after school during the school term and full time in the summer. Three programs offering preschool day care to handicapped children serve 131 children. One program provides day care for 54 senior citizens. All day care programs provide comprehensive social services to the families of children and adults enrolled. Transportation services for handicapped and elderly clients is provided by one agency in a semi-rural area to an average of 70 persons per month receiving 242 units of service (trips) per month. Emergency Shelter for abused and neglected children is offered by one agency with 14 slots. Two agencies provide Foster Care Services to 73 children in Foster Care.

CDC&CSSA provides accounting, bookkeeping, secretarial and payroll services, centralized reporting of Social Service Block Grant program enrollment and expenditures, and is a sponsoring agency for the United States Department of Agriculture Child Food and Nutrition Services Porgram. Additionally, the CDC&CSSA central office staff provides consultation in program and fiscal areas, technical assistance in budgeting and proposal formulation, training in specific program areas, liaison with the Department of Human Services, reviews, consultations and updates on Federal legislation and requirements. Not necessarily every subcontractor uses all of these services but, by agreement, all or combinations of the above are centrally provided and/or controlled.

In the interest of assuring that the Association's subcontracted programs and grantor entities were adequately and consistently insured, the negotiation and procurement of insurance coverage for the programs has been reserved and consolidated as a responsibility of the administrative management provided by CDC&CSSA. This consolidation of property/casualty insurance procurement is only one aspect of the above enumerated functions consolidated under the management auspices of the Association, for economies of scale or efficiency.

The combined fiscal year 86 budgets of the subcontract programs managed and supervised by the Association, for which we negotiate insurance coverage, toatal $3,392.200. The multi-peril liability property and casualty coverage our broker is asked to place, encompasses fifteen day care center locations providing 16 separate programs for children and 1 for adults, 6 group homes for children in foster care, the Association's offices, eight vans and school buses and five automobiles or utility vehicles. In addition, fidelity bonding, loss of valuable papers, comprehensive glass breakage, client accident insurance, workmen's compensation insurance and directors and officers liability insurance comprise the balance of the coverage.

As square footage is an actuarial aspect of liability coverage, the programs utilize and insure building premises of 81,819 square feet and fourteen playgrounds. The expressed value of buildings owned and insured is $1,162,200 and contents of $200,000. A potential 1,337 children and/or adults are served on any given day of operation.

CDC&CSSA has enjoyed a very positive working relationship with the E. H. Crup and Company insurors over the past four years. During two of those four years, the Crump Company through their brokerage activities assisted in the planning, placement and management of the Association's insurance coverage when the Association also managed and operated an Office of Juvenile Justice Delinquency Prevention Federal Demonstration Project serving twenty-five violent juvenile offenders in a "secure" penal facility environment.

The annual insurance premiums paid by the Association prior to fiscal year 1986, were relatively fixed for three fiscal years. Therefore, we feel that the increases in the Association's premium costs are illustrative of dramatic increases in certain insurance lines for day care providers throughout the marketplace. A comparison of the premiums paid by the type of coverage for the fiscal year 1985 and 1986 follows:

	FY 1985	FY 1986	Percent increase (decrease)
Directors and Officers liability ($1, million)	$ 1,351	$2,027	50
Property	3,894	5,519	42
General liability ($300,000/$300,000)	3,080	52,280	1,697
Multi-peril	844	926	10
Commercial umbrella excess liability ($5 million)	1,850	0	(100)
Client accident	2,730	2,730	—
Automobile	8,091	22,699	280
Automobile excess liability ($1 million)	510	0	(100)
Workmen's compensation	6,044	7,843	30
Total	28,394	94,024	331

Discussion with the chief executive officers of other social service agencies, hospitals, local and state governments and school systems, as well as newsletters and other printed communications from professional organizations and groups with whom we are affiliated, indicate that the Association's insurance status is no worse and in many instances much better than that of similar social service organizations. We understand that the crisis which child care providers are facing in securing liability insurance has been addressed in hearing of the Select Committe on Children, Youth and Families, and the Subcommittee on Tourism, Transportation, and Commerce of the House of Representatives. Additionally, reports issued to the Senate Finance Committe this year by the General Accounting office addressed the need to re-examine the tax code dealing with property/casualty insurance companies in view of the profits generated in the insurance industry and loopholes in the ta code.

Social service organizations such as The National Association for the Education of Young Children, The Child Care Action Campaign, The Child Welfare League of America, The Children's Foundation, The National Association for Family Day care, The School Age Child Care Project and the National Head Start Association, to name only a few, have begun survey efforts among service providing agencies and the insurance Commissioners in all states regarding liability claims and loss data. To date the efforts of these groups and the actions of state Commissioners of Insurance have brought about he cessation of cancellations in mid-policy year and joint underwriting pools in some states. However, nothing has transpired to our knowledge which indicates that the insurance industry will provide affordable coverage, decrease the high premiums or provide more coverage to child care providers.

As social service agencies such as CSC&CSSA are anticipating fiscal reductions under Gramm-Rudman Hollings in programs serving the truly needy, we are anticipating further reductions of our services due to the cost of our insurance coverage. This impacts drastically on the current economy as 68% of the clients that we serve are employed and/or in training. Without these day care services many of our clients will face a return to welfare rolls.

Not a day passes in which we do not receive calls from current day care providers or individuals seeking to establish new programs, asking for information on how they can secure insurance coverage. Since we have been asked by our broker not to share the name of our carrier, due to the carrier's desire not to be bombarded with requests for similar coverage, we can offer little in response to those inquiries. At a time in Memphis when the need for more day care spaces overshadows the current avaialble market, the insurance crisis is presenting a major barrier for expansion of services.

Not only are programs not able to expand in the Memphis are due to insurance costs, but programs have shut down. Probably one of the most dramatic closing is that of the Head Start program in early March. That closure was due to the cancellation of their insurance policies. It is our understanding that the closure is temporary, until coverage can be found, but if secured the cost projections that they have received so far will nearly triple the costs they have currently budgeted.

We contend that it is unfortunate that such large premiums are demanded to secure insurance. These dollars could be better utilized for the cost of services to the client families. Even though we are currently reaching above 850 families in our day care programs, over 600 families are on our active waiting lists to be served. All of these are people who are unable to pay day care fees and who qualify under the Social Service Block Grant program's income eligibility guidelines.

In discussions with staff of the State of Tennessee Department of Commerce and Insurance, we have inquired about joint underwriting or assigned risk pools and self-insurance coalitions as potential alternatives to the problem. It is our understanding that legislation would be required where the insurors are unwilling to voluntarily establish such alternatives. Should those alternatives be voluntarily established, and the high premium costs, restrictions and exclusions to the coverage provided by the industry not be relieved, the quality and quantity of service we provide will have to be diminished.

In conclusion, we have found very few alternatives to suggest beyond some form of State or Federal intervention. Ultimately, legislation may be needed to set legal limits on liability in order to defuse the volatile liability insurance premium hikes. In the case of social service programs such as those of the Association, which receive significant government financial participation, serve low income and handicapped persons, and have no means to pass on the premium increases to our consumers, a federally assured re-insurance for social service liability carriers may be necessary to bring policies within fiscal reach. Lastly, if the crisis persists or increaes, we would suggest Congress pass a liability program similar to the federal flood or crop insurance programs to assure the protection of the human service agencies, Head Start programs, public and private schools, etc.

Thank you.

Chairman Pickle. Thank you, Ms. Williams.

Let me ask you this, Dr. Baker and Ms. Williams. You have testified that your insurance premium has gone up 300 to 400 percent, in that neighborhood. So far, you have met that increase, I take it, and you are paying for that.

Is that correct, at this point?

Ms. WILLIAMS. Yes. We were able to——

Chairman PICKLE. How much more of an increase can you take?

Ms. BAKER. We can't. It means for the organizations in the National Assembly, the agencies, that while they are doing it for this year just to exist, it can't continue.

Some of the affiliates will have to close. To meet the payments, we have had to reduce staff, programs. It is a deteriorating situation.

Chairman PICKLE. Your next alternative is, if the premiums go up much more, you'll have to close?

Ms. BAKER. We are out of business.

Chairman PICKLE. Mr. Barker said the same thing; that his alternative would be to close.

Have any day care centers that you know of in your area closed yet; and if so, how many of them have closed? A small number? A large number? Or are most of them just hanging on? What is the status of it now?

Ms. BAKER. If we look at the 29 agencies under National Assembly, it is a small percentage. Next year, it will be a much larger percentage.

Mr. BARKER. In 24-hour care, six in Texas; and eight in the State of Arizona. Those are 14 that I am aware of.

Chairman PICKLE. How many in Texas?

Mr. BARKER. Six.

Ms. WILLIAMS. I don't know about statewide. In Memphis, the first week in March, all the Head Start programs were closed. They did not have insurance coverage. They were able to secure coverage last Wednesday and opened back up.

Chairman PICKLE. Have you had suits and damages assessed against you in any sizable amount in the last year or two?

Ms. WILLIAMS. We have only had two lawsuits in the last 15 years, and those were 7 years ago.

Chairman PICKLE. On what basis do the companies increase your premiums so much when you haven't had any lawsuits?

Ms. BAKER. That is what is so perplexing to us. We are not sure how that is assessed.

Chairman PICKLE. They say that because the potential is there, they have to raise your premium 200 to 400 percent. If that happens and you close, where do the children go?

Mr. BARKER. Children don't go away. They don't cease being abandoned or becoming mentally ill. Child abuse doesn't cease because insurance companies stop writing the premiums. The States will have to take care of those children in State institutions.

Chairman PICKLE. If they are private day care students, they have to go back to their homes or be cared for. But if they are in federally financed nonprofit custodial care, a lot of them have no home to go to. Where will they go?

Mr. BARKER. I think they will be cared for at a higher cost in State facilities, because the private not-for-profit sector will go away. Some of the costs going to the private sector will dry out because those private agencies will not be in existence.

Chairman PICKLE. Mr. Barker, you have suggested that the Federal Government monitor the insurance industry, and you suggested further that the insurance industry should be required by the Federal Government to provide insurance.

Ms. Williams recommended that Federal insurance be provided in certain child care facilities, much like we do flood insurance.

Those are alternatives. The primary concern we must have, as I see it, is that you be able to have insurance at a reasonable rate in order to keep operating in a way that helps society as well as the individuals. We are trying to understand why your premiums went up so high without any losses.

Ms. WILLIAMS. Our broker was trying to find out why we had such a large increase. The only thing he could come up with is we were day care and now day care facilities are under fire with the media, as far as child sexual abuse, and that was the only reason he could give us.

Chairman PICKLE. Mr. Anthony?

Mr. ANTHONY. You are representing a broad, broad cross-section of organizations that provide needed and necessary services. Yet, I didn't hear one of you complain about million-dollar judgments. I didn't hear one of you complain about contingency fees or joint and several liability.

Are you telling this committee that the tort system, as far as your industry is concerned, is not broke? You don't have the high judgments across the board; in other words, your experience rating is good?

Ms. WILLIAMS. Yes.

Mr. ANTHONY. So, you have somebody that watches "60 Minutes" and reads the news, Time and Newsweek, and he says we may have a problem out there, and be sued, and exposed to this great liability, and therefore we will cancel everybody's policy and withdraw from the market. And when we come back into the market, we will ask for a 1,000 percent increase in premiums.

They canceled your insurance. And, say, if you want it, beg for it. And then you have to sign a note that you won't tell an oversight subcommittee who they are. Tell them they are about as chicken as anybody I have seen. If they are in the market selling insurance, they ought to be advertising the fact and not asking you to come before this committee and hide their name. Tell them that is not the way to make friends in Congress. They ought to be sitting beside you testifying, rather than asking you to withhold something from this committee. It is aggravating.

The first panel of witnesses that we had were the witnesses representing the insurance companies. They were asked specifically if there was a problem within the day care area and the other areas of services you are trying to deliver. They said the crisis is over. They said they are six and seven companies writing insurance.

Are you getting six or seven bids?

Mr. BARKER. I will name a company, because I have a letter. Gracer General, that had provided our general liability and professional malpractice coverage, wrote us a letter and gave a 30-day notice stating they were not going to renew. We had had our coverage with them for 3 years claim-free; premiums had gone up gradually. And we assumed we would have an increase of 20 to 25 percent, but they gave us zero option. They said we are not writing that coverage for any folks providing care of children.

We spent a horrendous 30 days trying to replace our coverage; utilized the connections of some of our board members to try to work with national general agencies, trying to place our coverage. Some three-fourths of the companies that we approached simply said they were not interested in writing coverage.

We finally found the coverage, but the total premium went from $36,000 a year to $76,000 in order to get the same basic coverage at the upper limits, although the deductibles tripled.

To keep the premiums down, we decided we had to carry a much higher deductible on the front end of the claims.

Mr. **Anthony**. This is a consistent experience?

Ms. **Barker**. The horror stories are many. We could sit all afternoon and talk about individual situations.

In addition to child care, there are the other services that are offered throughout all of the communities in our Nation that are being threatened: The care to the elderly, the care to youth, and care to abused women. And we will not be able to offer those services.

So, it is more than where will the children go. It is where will those needing these services go, and what will they do if we can no longer be able to pay these insurance rates.

Mr. **Anthony**. I think you have been a powerful panel for your cause. I say to the insurance industry, if you are going to ask children and elderly to subsidize your mismanagement practices over the last 5 years and try to jack up their premiums and get it back in a year, you better move over because the Government can subsidize that as well as anybody else.

I am not satisfied that we have heard the proper answers to the questions and the examples that you have laid out here, I think we ought to challenge, Mr. Chairman, the industry to take a look at these statements and, if necessary, convene a fourth day of hearings later on to give them an opportunity to rebut and state on the record exactly how this crisis is over with.

I am not hearing that the crisis is over. It is something from a national public policy standpoint that is very, very disturbing to this Member.

Chairman **Pickle**. We may be able to have an additional hearing. We do have a third day of hearings that has been scheduled.

Mr. Frenzel?

Mr. **Frenzel**. I am a "Johnny come lately," and I missed a good deal of your testimony. Let me tell a little story and see if it is contrary to your experience, or maybe you would comment on it.

The House of Representatives wants to create a day care center, and we had put all of the necessary apparatus into being to create a day care center, except that we were unable to get liability insurance. I happened to know a person associated with a company that I thought wrote such insurance, communicated with that person, and said what would happen if we asked you for a bid? He said, "We would not provide one."

I said, "Why not?"

And he said, "Well, so far our claim experience is that we have got $8 worth of claims pending for every dollar of premium that we have received."

So I said, "OK, that is pretty persuasive in your case."

Remember, this is anecdotal because I can't name the person or the company. It was a privileged communication. I was just asking him as a friend.

Then I said, "Is there any case that you would write insurance in?"

He said, "Only in the case of a town under 5,000 population where the service was furnished by a church and restricted to the use of that church's parishioners."

Now, again, this is a very isolated, one-time experience with the problem. But it leads me to believe that the increases are not based on an unwillingness to provide the service or desire to jack up somebody's prices, but on a real fear of bad claim experience. I would like to have you simply comment on that statement, whether you think maybe it is isolated or whether you think there may be something behind it.

Any one of you who wants to volunteer, or all, I would be delighted.

Ms. **BAKER**. In the examples that I gave, that has not been the case. It has appeared to be the fear or whatever is generating the increase in cost, because there has been no attempt to look at the population that is being served and even put the limits that your situation has offered. So that is not applicable to our situation.

Mr. **BARKER**. That doesn't seem to be the case in 24-hour care, when children are living away from their parents. A survey of the Child Welfare League of America indicated new claims have been adjudicated against league member agencies, but the premiums have gone up considerably without a claim experience.

Ms. **WILLIAMS**. We have only had two suits brought against us, one where a settlement occurred and the insurance carrier decided not to go to court with it. I think we could have won in court.

No one has given us evidence that we are really a higher risk. We have a lot of entities monitoring the agencies. We have more people coming in out of our programs than private entities. So I would say the risks are really not there.

Mr. **FRENZEL**. I wonder if this is a particular field where insuring companies and the insureds are not in a great hurry to go to court.

Ms. Baker or Mr. Barker, is that your feeling?

Mr. **BARKER**. You mean that there is likely to be out-of-court settlement?

Mr. **FRENZEL**. In one case, Ms. Williams said she thought there was a good chance it would not have been accepted.

Ms. **WILLIAMS**. That is correct, because all the proper precautionary measures had been taken, and it was less costly to just settle out of court.

Mr. **FRENZEL**. That is always my complaint with my insurance company, too.

Ms. **BAKER**. I think the interesting thing here is that the industry has not been made accountable in terms of telling us the reasons why the insurance is increasing. The reasons are all over the place. But it doesn't appear as though anyone has encouraged the industry to, or has conducted a study or insisted that a study be done, so that we know exactly what is causing the increases.

Mr. **FRENZEL**. Thank you very much.

Mr. Chairman, I yield the balance of my time, and I thank the panel.

Mr. **Anthony** [presiding]. Thank you, Mr. Frenzel.

One followup question. You had testimony that you were having difficulty getting liability insurance for your independent board of directors.

What has been the experience of lawsuits filed against your independent board of directors?

Ms. **Baker**. I am not prepared to respond to that because I represent 29 associations across the country which have many agencies.

Mr. **Anthony**. Does anybody have data on how many of your independent boards have been sued? If you could inquire and then report back to us what your findings are, because, as I understand it, this has been one of your problems. Have you had a withdrawal of people that would want to serve on these boards as a result of their perceived exposure, and therefore their personal fortunes being subject to attachment and judgment?

So anything that you could assist us there—Ms. Baker, I think maybe you asked the $64,000 question. Maybe we can do it with some letters back to the representatives of the insurance companies, and that will give us a better explanation on a loss ratio versus premiums collected, as to why you withdrew and as to why the premiums had to escalate in such a high fashion. Maybe we could make a more complete record.

But if there is any additional information that your associations could gather for us, as far as asking them to take a look at it, I think it would help.

But thank you for participating.

Ms. **Williams**. Thank you.

Ms. **Baker**. Thank you.

Mr. **Barker**. Thank you.

Mr. **Anthony**. Our next panel consists of three witnesses: Aubrey Griffith, risk manager, Belz Enterprises, Memphis TN; Milton F. Lunch, general counsel, National Society of Professional Engineers; and Dennis Long, financial consultant, Scienco, Inc., Memphis, TN.

Mr. Griffith—all three of you will have your full statements submitted for the record, and you are at liberty to summarize as you see fit.

Mr. Griffith.

STATEMENT OF AUBREY E. GRIFFITH, CORPORATE RISK MANAGER, BELZ ENTERPRISES, MEMPHIS, TN

Mr. **Griffith**. Thank you, sir.

I consider this quite an honor to be here. I have never been before this type of panel before, and I hope I am in a position to give you the answers that you are seeking. And I will handle my end of this testimony more or less as a rebuttal relative to the insurance companies.

Prior to my starting, I wasn't here this morning in regards to Mr. Nader and his panel's presentation, but I want to go on record stating that the Lloyd's of London, if it weren't for them, I am afraid that the industry would be in a much worse condition than it is today.

The statements made by the insurance representatives, in my opinion, do not address the issues. The information that you have listened to all day—and I am sorry if this is going to sound repetitive and redundant—but the industry has put the public in a very precarious and untenable position due to the fact that they failed to use what is known as sound underwriting practices, and they went ahead with the cash-flow theory without any regard for the consequences that lay ahead.

The industry was well aware of the consequences in 1983, and they failed to take advantage of the signs that were surfacing. Consequently, they underreserved their losses and they—by "they," I mean the primary carriers—put the reinsurance market in jeopardy.

Now, in order to overcome this gross mismanagement, the industry is putting the burden on the public by charging these unaffordable and outrageous prices within a period of a very short period of time, which took 6 years to erode the industry.

The only source of attaining excess limits is through the reinsurance companies, and unfortunately the market is in a disastrous condition because of the primary carrier.

There is one important aspect that has contributed to the insurance crisis, and this bears on the legal aspect of it, which is known as the deep pocket. Someone is injured; someone is going to pay. The judgments that have been allowed through the civil justice system are absolutely outrageous and unconscionable.

I have cited a few cases, which is part of the transcript, which I will not elaborate on. I want to get to the problems, the judicial problems, which I will address later.

The principal of my company is on a board of directors of a hospital, and the premium in 1985 was $5,500. It is now $88,000. The insurance companies are also promoting what is known as a claims made basis coverage. However, they failed to inform you all this morning that the gap in coverage is going to be extremely harmful, particularly to those that don't have sophisticated knowledge of the industry.

For instance, if you were to take a policy out January 1, 1986, on a claims made basis, and the present carrier decided not to write the insurance for the year 1987, any and all losses that occur in that period will not be covered—only if you buy what is known as the trail—and the trail through the bureau of companies is 60 days. But you can buy an extension, say, for 5 years, but at a cost of 200 percent. In my particular case, that means $800,000.

Now, there are some comments I would like to make also about the insurance commissions of the United States, and I know they are trying to do a good job, but they have a tendency not to say no, and the reason being is the hearings that I have attended in Tennessee, the insurance companies have a tendency to what I see as intimidation. You either take this claim rate form or we are going to withdraw from the State.

Another factor I want to bring to the attention of the committee is, come July 1, 1986, the defense cost will be all-inclusive in the annual aggregate, which means now that from a primary coverage point where I would ordinarily carry $1 million on a primary, I am going to have to go and buy an exorbitant amount of excess coverage, because as soon as those limits are exhausted through legal expense and judgment, the excess carrier will have to sit down and perform the responsibility of the primary carrier.

Sirs, I am in a position to hopefully answer some of your questions and give you answers to some that weren't answered this morning.

[The prepared statement follows:]

STATEMENT OF AUBREY E. GRIFFITH, CORPORATE RISK MANAGER, BELZ ENTERPRISES, MEMPHIS, TN

The precarious and untenable position in which the insurance industry has placed the insurance buying public stems in large part from the disregard for sound underwriting practices and having substituted what is known as cash flow underwriting; getting as many premium dollars as possible in the shortest period of time for investment without any concern for losses. This situation prevailed for approximately six years, coming to a halt in the middle of 1985.

The industry was well aware of what the consequences would be, but they chose to disregard the warning sings which started to surface in 1983. As a result of this cash flow policy, two important areas had been affected. One is that the losses were under-reserved. Number two, the reinsurance market was put in jeopardy because the various risks that were ceded to them.

Now, in order to overcome this gross mismanagement, the industry is now putting the burden on the public by charging these unaffordable prices and, in addition to that, they are withdrawing a lot of the coverages that were previously available.

The only source of attaining excess limits coverage is that which is provided by the reinsurance companies, which have practically withdrawn from the market because of the disastrous experience that they suffered as a result of the primary carriers underwriting philosophy.

There is one other important aspect that has contributed to the insurance crisis and that is what is known as the "deep pocket theory"; I.E., "someone has been injured and someone is going to pay". The judgements that have been allowed through our civil justice system are absolutely outrageous and unconscionable. I am citing a few cases that appeared in the Nation's business publication for the month of February, 1986, which clearly illustrates the foregoing contention:

1. An overweight man with a history of coronary disease has a heart attack while trying to start a lawn mower. In a suit against the manufacturer, he argues that pulling the starter rope required excessive effort. A jury awards him $1 million in damages—plus interest.
2. A drug dosage administered by hospital personnel to a child who then suffers brain damage exceeds the manufacturers's specifications. The child's parent nevertheless sue the manufacturer—and are awarded $22 million.
3. A motorcyclist, injured when he runs off the road into a parked truck, sues the truck's owner. A mediation board, citing the motorcyclist's own role in the accident, limits a damage award to $20,000. The case goes to a jury, which increases the award to $4.2 million.

The above examples of recent damage awards are not isolated instances but are part of a cycle that is pulling more and more businesses, particularly smaller and medium-size ones, into what has become one of the most serious problems facing business today—the liability insurance crisis.

The casualty insurance situation has become so critical that physicians, day care centers, hazardous waste handlers and many other businesses are forced to close due to the inability of the industry to service these people appropriately.

My employer, "Belz Enterprises", is in the commercial and industrial development business. We build, own and operate the following types of structures: Hotels, industrial parks, shopping centers, office buildings, port facility, fixed based airport operation, and sewage treatment plant for domestic water only.

The premium comparison paid for the year 1984 as opposed to 1985 is as follows:

Coverage	Premiums	
	1985	1984
Primary General Liability—Limits $1 million without any retention in 1984; $25,000 retention in 1985	463,000	240,000
Excess umbrella coverage—$100 million limits in 1984; $10 million in 1985	870,000	105,000
Environmental protection liability for sewage treatment plant—limits $2,500,000 in 1984; $1 million limits in 1985	50,000	16,000

At the port facility operation in 1984 we had available $5 million coverage as it relates to umbrella program at a cost of $3,000. Now it is unavailable at any price. The primary coverage for $2 million limit was $12,000: Now it can be obtained for $24,000. It is noted that we have not had any claims.

The foregoing only tells part of the story. One of my principals is on the board of directs for one of the city's largest hospitals and their directors and officiers liability premium for 1985 was $5,561 and the renewal quotation is in the amount of $88,500; an increase of more than 1,500%!

In all probability, the situation that currently exists is going to have a devastating affect on American business. How can our products be competitive with those of the foreign manufacturer when the business community has to pay outrageous prices? Belz enterprises has engaged in long term contracts with our tenants. Consequently, there is no way that we can pass on this exorbitant cost.

The insurance companies are now offering liability coverage on what is now known as a claims made basis, which means that the loss will be paid only if it is reported and a claim is made within the policy period, as opposed to an occurrence basis, which the loss could take place in the policy period and reported at any time. Because of the language of this particular form, the gap that will be created is going to be extremely harmful to the unsophisticated buyer. In order to extend the policy beyond its expiration date and to pick up claims that have not yet been reported will cost the insurance buyer 200% of the premium of the policy that expired. In our particular case, it would be $800,000.

They are proposing and, in fact, will make effective July 1, 1986, that all defense costs will be inclusive in the annual aggregate. An annual aggregate is the total amount of liability that the insurance company will be obligated to pay. For example, if you have limits of $1 million and the judgement is for $500,000 and the legal fees amounted to $300,000, that leaves only $200,000 that the insurance company will be obligated to pay during that entire policy year. The consequence of this proposal means that the insurance buying public will have to buy an exorbitant amount of excess liability (if available) at an extremely high cost because the excess carrier will have to step down and take the place of the primary carrier when the limits are exhausted.

In order to overcome the industry's inability to offer affordable insurance and the coverage, alternatives are going to have to be found. One is to self insure certain aspects of one's operation and have the Internal Revenue Service recognize the reserves that are absolutely essential to this type of alternative to be recognized as a deductible item. The maintaining of a property reserve to pay future losses is just as essential as allowing depletion credits and/or depreciation.

Property insurance is experiencing the same problems as it relates to availability and cost. Our rate for a $10,000 deductible in 1984 was 8 cents per 100. For the same coverage in 1985 the rate is 33 cents per 100. The difference in these rates equates to a $2 million increase in premium.

Mr. ANTHONY. Thank you.

Mr. Lunch.

STATEMENT OF MILTON F. LUNCH, ESQ., GENERAL COUNSEL, NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

Mr. LUNCH. Thank you, Mr. Chairman.

We have a prepared statement which I understand will be included in the record, which refers to a document that our organization produced in January, called a "White Paper on the Liability Crisis," and I understand copies of that white paper have been furnished to the subcommittee.

I think there is probably little need at this point, after your extensive array of witnesses, to repeat what I am sure has been said over and over about the nature of the liability crisis, the tremendous increase in premiums, the unavailability of liability insurance, and the need for tort reform, all of which we have discussed in our statement and in the white paper.

Just a few statistics pertinent to the engineering profession, which I am associated with here, for the purpose—our liability insurance situation involves an average of 44 claims per 100 firms; that is, firms offering engineering services to the public. Of those 44 claims per 100 firms, only about 10 result in an indemnity payment. But of those which do not result in an indemnity payment, there is still a substantial cost in legal defense costs up to the point that the claim is terminated without indemnity payment or is dismissed.

So, for the engineering profession it is a problem, much as it is for all the other elements of the economy that have testified before your hearing.

In some respects, Mr. Chairman, the engineering profession is better off than some of the other groups that have testified here. Professional liability insurance is still available to our members. True, a few years ago there was something like 10 or 12 insurance companies that would write professional liability insurance. Today, we are down to two at best. And I say at best because one of the two has a very limited reserve capacity and is unable to expand its policy coverage very much because of that.

I would like to respond in a sort of a way to a comment or a question raised by Mr. Frenzel at the last panel with regard to classification of these risks from an insurance or noninsurance point of view, and I would like to focus the point here on asbestos.

Now, under the professional liability insurance policy for engineers—and this applies also to architects, sir—today there is a total exclusion of coverage for anything connected with asbestos or anything connected with pollution activities. If a local community has a need to develop a landfill for waste disposal, it will be very, very difficult if at all possible for that community to find an engineering firm qualified and willing to take on the engineering development of that landfill, because that landfill operation would not be covered by liability insurance under the present exclusion for anything related to pollution as very broadly defined.

Let me refer to the asbestos situation. We have thousands upon thousands of buildings in this country that have asbestos. Many of these are public buildings, schoolhouses, firehouses, community halls, et cetera. Under the policy, the liability insurance policy available today, it would be very difficult, if at all possible, to get an engineering firm or an architectural firm to become involved in making a study of the asbestos removal problem, because if anything goes wrong or someone thinks something went wrong, those firms are subject to liability suit with no insurance protection.

Now, why should this be? There has not been a single case to date in which an engineering firm or an architectural firm has had a claim filed against it or a suit filed in court involving asbestos activities. The insurance company's answer comes down to one word—"fear." They point to the *Manville* case involving billions upon billions of dollars potentially, and they say we don't want to take that chance.

Whether this is a fair and proper response of the industry is a good question. We all know that insurance is broadly defined as a sharing of the risks in a defined class of exposure. But when we have a situation where there has not been a single case to date of a claim involving asbestos activities on the part of engineers or architects, I think we can properly ask a question, which I thought Mr. Frenzel was directing his comment to, whether that is a proper classification to deny coverage for that very, very potential risk area for the insurance industry.

There are many other things that have been said, can be said. But I see the red light is blinking, so I will cease now and be glad to respond to any questions the members of the subcommittee may have.

[The prepared statement follows:]

STATEMENT OF MILTON F. LUNCH, ESQ., GENERAL COUNSEL, NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

Mr. Chairman,

My name is Milton F. Lunch. I am General Counsel of the National Society of Professional Engineers. NSPE is a professional society, representing more than 75,000 engineers of all disciplines nationwide. Our members are organized into 54 state and territorial societies and 535 local chapters, and are engaged in work in industry, education, private practice, construction and government.

The liability crisis affects our members along with virtually every segment of the American economy. A person would have to be a modern Rip Van Winkle to be unaware of what has been happening in the liability area. It has been featured in national television programs, written about extensively in newspapers and magazines, and has been the subject of almost endless seminars and conferences. Coalitions have been organized at both national and state levels to try to deal with the problem of lack of liability insurance, sensationally higher premiums and increases in deductibles, plus the total exclusion of some kinds of activities where the insurance is still otherwise available.

NSPE has recognized this concern as a Number 1 priority in its current programs and has produced a special report (white paper) on The Liability Crisis. A copy of that special report is appended to this statement.

There is little need at this point to again review the numerous "horror" stories of the impact of the liability crisis on professional practitioners (doctors, engineers, lawyers, architects, etc.), or on the business community generally, to say nothing of municipalities, child care centers, recreational facilities, and almost any kind of enterprise one can imagine.

There has been and will continue to be a debate over the causes of the crisis. But finger-pointing will not serve any useful purpose. The fact is that there are numerous causes. Chief among them, it is generally agreed, is the admitted fact that the casualty-property insurance industry seriously eroded its premium base in recent years at a time when interest rates were in the 20 percent range and the insurance underwriters scrambled to sell liability insurance at less than adequate underwriting rates to generate cash flow for investment income. Those chickens have now come home to roost as the interest income has dropped significantly.

A major factor in the difficulty of finding adequate liability insurance is the substantial withdrawal of reinsurance companies from the market. These are mainly foreign-based companies and they have expressed the view that in view of the uncertainty of the American market and what is happening in the courts makes the risk intolerable.

Another major "culprit" in the picture is the legal profession. In recent years a much greater number of lawyers have entered the field of liability practice -- membership in the American Trial Lawyers Association has tripled. And directly related to the greater number of lawyers specializing in liability cases on behalf of plaintiffs is the trend in the courts to find new and novel theories of liability, and the acceptance of enormous jury awards against defendants once liability has been established.

But in the final analysis, I would submit, the ultimate "culprit" is the American public, which has increasingly adopted a philosophy of a riskless society and an attitude of looking for the "deep pocket" without much regard for determining who was really at fault. After all, the enormous jury awards we read about are made not by lawyers and judges, but by juries who are drawn from a cross-section of the public.

This basic change in attitude, while it has been most recognized in recent years, actually started in its present form as far back as 1916 when Judge Cardozo laid down the basic rule that in negligence actions there would no longer be a requirement of privity between the manufacturer and the injured party (McPherson v. Buick Motor Co., 111 N.E. 1050).

In 1944 Justice Traynor of the California Supreme Court laid down the judicial basis for the "deep pocket" rule, and which is now embodied in text book law:

> "Even if there is no negligence...public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market. It is evident that the manufacturer can anticipate some hazards and guard against the recurrence of others, as the public cannot. Those who suffer injury from defective products are unprepared to meet its consequences. The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business. It is to the public interest to discourage the marketing of products having defects

> that are a menace to the public. If such products nevertheless find their way into the market it is to the public interest to place the responsibility for whatever injury they may cause upon the manufacturer, who, even if he is not negligent in the manufacture of the product, is responsible for its reaching the market. However intermittently such injuries may occur and however haphazardly they may strike, the risk of their occurrence is a constant risk and a general one. Against such a risk there should be general and constant protection and the manufacturer is best situated to afford such protection."
> (Escola v. Coca-Cola Bottling Co., 150 P.2d 436)

While Justice Traynor spoke to injuries from products, the philosophy he expounded has now been extended across-the-board to professional services, municipal services, educational activities and other fields of endeavor.

As set forth in some detail in our "white paper", the current emphasis to achieve a change in the situation is on tort reform. This includes changes in state laws governing limits on punitive damages, a reduction in contingent fee rewards to successful plaintiff attorneys, a limitation on "pain and suffering" awards, stricter application of state laws and court rules to punish those who file frivolous law suits, more use of structured settlement arrangements, elimination of the collateral source rules, and abandonment of the joint and several liability doctrine.

One of the most fruitful sources of reform would be to achieve greater use of non-judicial proceedings to determine fault and compensation for those entitled to it. Arbitration is one such widely-used method for this purpose, but applies, of course, only where there is a contractual relationship between the parties and those parties have agreed to resolve the dispute by a formal arbitration agreement. It does not apply to tort actions by third parties. Some courts have opted for a mandatory arbitration technique where the claimed damages are below a certain figure. A number of states have enacted pre-trial panel requirements whereby the parties are required to present their claim to a non-judicial panel, which after a hearing issues an advisory opinion, subject to a full trial if either party is not willing to accept the panel's conclusions. There are numerous variations on these themes and only time will tell to what extent such techniques will help alleviate the situation.

By this time virtually all of the states have entered into the marketplace of ideas to deal with the liability crisis. State legislatures have established study committees, governors in many cases have organized commissions to recommend constructive approaches. Some action has been taken in several of the states dealing with the various kinds of tort reforms noted above, such as enactment of a cap of $250,000 on pain and suffering awards, or a cap on punitive damages.

The Department of Justice has in being an inter-agency study group, which is expected to issue its report shortly. Attorney General Meese has indicated that the conclusion, not surprisingly, will be to call upon the states to enact tort reform legislation of the type mentioned. There is a broad consensus that the primary role will be that of the states under our federalism system in which the states have always had the responsibility for enactment of laws governing liability claims between private parties. It has been suggested that the Federal Government might enter the arena by Congress enacting criteria and limitations for tort cases handled in the federal courts, but this would run afoul of the long-standing doctrine that the role of the federal courts under its diversity jurisdiction is to interpret and apply the law of the state in which the case is heard.

In the particular case of the concerns of engineers, over and above those generally applicable to all, our members now face a total exclusion of insurance coverage for activities involved in pollution-related claims, including asbestos. There is an urgent public need to clean up hazardous waste sites, and this requires the expertise of engineers, among others. But our members qualified and interested in performing that service face the choice of gambling the entire assets of their firm if faced with claims arising from that activity, and possibly the assets of the individual engineers in those firms. Hopefully, relief will be afforded in this area through enactment of indemnification authority to EPA under the pending Superfund bill. Both the House and Senate bills provide for such authority, and we look to the conferees to approve that kind of provision.

The situation with removal of asbestos is more difficult. There is no pending legislative relief in sight, and engineers are understandably reluctant to meet the call of federal agencies, school boards and others to participate in the planning and design of procedures for the asbestos removal. To illustrate how far this problem has gone, a recent decision of the U.S. District Court for the District of New Jersey holds that a manufacturer of asbestos may not use the state-of-the-art defense in an asbestos-related claim to show that the danger of which it failed to warn was undiscoverable given the state of scientific knowledge at the time the product was marketed. (In re Asbestos Litigation, Misc. No. 85-381, 2/14/86, 54 LW 2427). This decision applies to manufacturers, but in view of the current atmosphere engineers and others involved in asbestos removal projects may well fear that the same rule will be applied to them.

Everyone is looking for solutions to this dilemma. The solutions are many and varied, ranging from court rulings to tort reform legislation in the several states, but primarily a continued emphasis on the need for a change in popular public attitudes, and a recognition that in the long run the tremendous cost borne by defendants will be passed on to the public in the form of higher costs of products and services. As stated by Lee Loevinger, an eminent attorney, in a recent paper on "Science, Technology and Law in Modern Society" in Jurimetrics, a publication of the Section of Science and Technology, American Bar Association, Fall 1985:

> "There undoubtedly are cases of genuine malpractice where litigation and liability are quite justified; but it seems equally clear that the expectations of many patients, lawyers, judges and juries are ill-informed an unrealistic. There probably is no ultimate solution to this problem other than an education of lawyers, courts and the public to a more realistic understanding of the limits of science and technology in all fields, as well as a more modest appraisal of their own wisdom."

Our members, along with those of other professional societies, are actively participating in national and state coalitions with members of other professions, industry, municipalities, public service organizations, etc. to bring a coordinated effort to seek improvements in our civil justice system. Congress can play an important role in this kind of effort by hearings, such as this one, to bring about a greater recognition of the need for a change by all elements of society toward a restoration of the principle that those injured by malpractice or negligence are entitled to be compensated for their loss, but are not entitled to and should not be allowed to extend that recovery into unwarranted windfalls beyond actual loss. If this kind of change in philosophy is not accepted we will continue to see,on an accelerating basis,the closing of businesses, the inability of cities to provide necessary public services and the decline in the ability of American industry and the professions to provide products and services and the consequent loss of jobs for American workers.

We appreciate the opportunity to offer these comments and will be pleased to provide such further information or assistance as may be helpful.

a National Society of Professional Engineers

WHITE PAPER

THE LIABILITY CRISIS

published by the
Professional Engineers in Private Practice
and the
Legislative and Government Affairs Committee

This report was prepared by Milton F. Lunch, NSPE General Counsel, and reviewed for concept by the NSPE Liability Task Force and the NSPE/PEPP Professional Liability Committee. It is published for NSPE by the Professional Engineers in Private Practice, a semi-autonomous Practice Division of NSPE, and the NSPE Legislative and Government Affairs Committee.

Appreciation is expressed to Paul L. Genecki, Senior Vice President, Victor O. Schinnerer & Company, Inc., administrators of the NSPE/PEPP-endorsed liability insurance program, for reviewing the text and providing the insurance data.

It is intended that this report will serve as a basis for further cooperative programs with other professional societies and trade associations through the work of the Committee on the Liability Crisis of the Interprofessional Council on Environmental Design composed of The American Institute of Architects, American Society of Landscape Architects, American Society of Consulting Planners, American Society of Civil Engineers, American Institute of Certified Planners, American Consulting Engineers Council, and the National Society of Professional Engineers.

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THE LIABILITY CRISIS

INTRODUCTION

At midnight on September 11, 1985 the town of Sykesville, Maryland (population 2200) went out of business.

At that hour the town's liability insurance expired and the town had been unable to find any replacement policy. The elected and appointed town officials resigned their positions and terminated all town services to the town's citizens. Their stated reason was the fear that they might be held individually liable for claims arising from the activities of the town or the services rendered by the town, ranging from street repair, water supply maintenance, enforcement of police laws, traffic control, and the host of other day-to-day functions which residents of towns and citizens routinely expect and hardly think about.

The Sykesville case is not unique or even special any longer. The loss of liability insurance because it is no longer available, or because the premiums are out of reach, has now extended to all elements of society. Child care centers are closing, school boards must close down schools with asbestos installed years ago, midwives are leaving the field, hospitals increasingly raise patient charges to cover ever-increasing premiums.

These concerns are not new to the professions. Engineers, architects, medical doctors, accountants, and now even lawyers (who are often blamed for the crisis) are feeling the pinch in terms of loss of coverage or substantial premium increases.

The purpose of this special report is not to assess blame, or to present solutions, as such. Rather, it is intended that it will be beneficial to members of NSPE, and others, to understand the background of how this all came about, what is the current situation in particular aspects of the problem, and what actions are underway or contemplated to deal with the many and varied issues which form the total crisis.

The emphasis of this report will naturally be on the implications of the problem for engineers, but not confined to those in private practice or any other single segment of the profession. Likewise, it discusses the relationship of the concerns of engineers with those of the other professions, but recognizing that there are major differences between the professions in light of their different forms of practice and liability exposure.

The liability crisis is not confined to the professions. It sweeps across virtually all elements of society. For some ten years the manufacturing industry has attempted to enact a federal law establishing a uniform standard for product liability. Despite extensive efforts and substantial financing the effort has not been successful. In addition to the arguments about the substance of the proposal which is intended to lessen the liability exposure for product cases, there has been strong opposition to the idea of "federalizing" what has always been a state function. Currently, a revised proposal to establish a voluntary "no fault" system for product liability has emerged, but there is no indication that Congress will move in that direction at this time. The justification for a national standard in product cases is that products are often produced in several states and are sold nationally in interstate commerce. That is not the case, however, with professional design and related services, which are almost always located within a particular state.

Engineering employees are sometimes concerned with the possibility of being named as defendants on an individual basis. While this is a rare occurrence, it is possible, particularly for those employed in industry, government, contracting or education, among others. Even those in consulting firms which do not carry professional liability insurance may be vulnerable. Employees in firms with such insurance policies are covered under the policy along with the firm, but there may be liability exposure for employees who leave the firm and go into non-consulting employment.

NSPE has attempted to provide for this potential exposure by a separate insurance program (jointly with ASCE) for individual employees. However, this undertaking did not generate enough support to justify its continuation from an insurance viewpoint. An effort to develop a new program for individual employees is continuing, but in the present state of the insurance industry there is no immediate prospect of success.

It is hoped that by this exploration of the problem, faced realistically from practical, economic, legal and ethical viewpoints, the engineering profession, working in concert with the other professions, may be able to play a constructive role in seeking remedies to a familiar, but now worsening situation; one which is heavily invested with an overriding public concern of health, safety and economic well-being of all citizens.

This report is presented in two basic parts. Part I is intended to deal with the current or immediate problems and to outline pending proposals to deal with practical approaches. These aspects of the problem reflect mainly the concerns of engineers in private practice and the efforts of the Professional Liability Committee of the Professional Engineers in Private Practice Section of NSPE. The Professional Liability Committee has worked extensively in recent months to monitor these fast-breaking developments, including meetings with the insurance administrators and underwriters to press for the best possible language to limit the new policy exclusions discussed under the section on policy coverage.

Part II relates more to the long-term problems which are at the heart of the crisis, but which will require a much more detailed exploration of causes and possible remedies. This aspect, which in general is referred to as "tort reform", will require many years of effort if fundamental changes in our legal system are to be achieved. Of equal, if not more, importance will be a better public understanding of the nature of a legal system which in many respects has gone berserk in evaluating and balancing the rights of plaintiffs and defendants in injury cases.

THE LIABILITY CRISIS

PART I—The Immediate Crisis

The most evident change in the worsening liability picture has been the very high increases in premiums charged to practicing engineers in recent years.

For twenty-eight years NSPE and the American Institute of Architects have endorsed a professional liability insurance program underwritten by Continental Casualty Company, and administered by Victor O. Schinnerer & Co., Inc. It has been a fully collaborative program during all of those years, with regular review of development since its inception by committees of the two societies, and with full disclosure of all pertinent statistics as the basis for premium development.

In recent years the premium rate increases resulting from increased claims have averaged:

1981	12%
1982	9%
1983	9%
1984	15%
1985	35%

Historically, average premiums have been approximately 2-3 percent of gross billings of consulting firms. With the projected increases for the current policy period it is expected that they will average approximately 4-5 percent.

It should be emphasized that average rate increases or percentage of billings do not mean that each policyholder received or will receive the same increase. Premiums reflect a host of factors—size of the firm in terms of billings, type of practice, geographical location and loss experience. Thus, a firm with a substantial growth in billings may well have an increase above the average. Because firms which specialize in structural engineering have experienced the worst loss records in recent years their premium currently is in the highest range. Those firms which practice entirely, or mainly, in the field of structural engineering, and which have not heretofore been insured under the CNA program are finding it most difficult to find any source of liability insurance.

Another significant development in the worsening liability insurance picture is a trend toward higher deductibles required of the insured firms. This obviously means that in the event of a loss covered by insurance the firm will have to dig deeper into its own pocket to cover the first element of the loss.

All of this, compounded by the withdrawal or reduction in the availability of reinsurance, has resulted in a substantial lessening of insurance underwriters for A/E professional liability insurance. Only a few years ago there were some ten or a dozen insurance companies offering A/E liability insurance. Today there are only a handful or fewer insurance companies willing to offer such policies.

It would be erroneous, however, to conclude that the crisis is an insurance crisis. The state of the insurance market is basically a reflection and result of the liability crisis.

The reasons for insurance underwriters dropping out of the market are complex, but clear. The main reason, of course, is the heavy losses sustained by these companies in recent years. According to recent reports, the casualty insurance industry, overall, has lost $3.7 billion in the past year. In the A/E program alone, CNA, the largest of the remaining underwriters, reported an underwriting loss of $113,000,000 on the first $1,000,000 limit of liability between 1978-1983 with an accelerating loss trend. It has been observed by insurance authorities that insurance companies are not mainly interested in premium income; they look for their profit from cash flow—from investment of the premium income. This formula worked well during the years when interest rates were in the 20 percent, or better, range. The underwriters were then content to absorb the underwriting loss and make up for it from the investment income. In this regard it is worth noting that invested premium income generates income for a long period of time before claims are resolved and indemnity payments made. Now, however, with interest rates at a much reduced level the cash flow-investment formula fails to produce a sufficient return to compensate for the increased costs of claims handling, indemnity payments and overhead.

As an indication of the deteriorating A/E liability picture from the insurance underwriter's standpoint, in 1983 (the latest available complete statistics) claims frequency remained fairly steady at 44 claims per 100 firms per year. Paid claims frequency (claims in which there was an indemnity payment) was 9.5 per 100 firms. But, severity measured in terms of average indemnity payment was reported at $148,000, representing an increase since 1978 of approximately $40,000 per claim. Also, during the same time frame, average claims expenses have more than doubled on a per claim basis.

Policy Coverage

As serious as the premium increases have been, in some respects it is not the most serious concern. The firms required to pay these higher insurance costs must of course, pass them along to clients as part of the firm's overhead. It has been suggested in that connection that in billing a client the A/E may choose to add a line item to the bill to represent the liability insurance part of the bill. Thus, if a firm is paying 3 percent of its billings for liability insurance it would add 3 percent of the basic bill to the client. This is a dubious tactic, however, on several grounds. First, the line item for insurance would represent double billing if the same 3 percent were in the overhead part of the firm's charge to the client. Second, it may well be questioned whether it is wise in any event to spell out to clients the extent of the A/E's insurance, thereby perhaps giving the client the false idea that it may as well file a claim for some imagined deficiency in the plans and specifications "because the insurance company will pay it."

From its inception, the A/E insurance policy has included certain exclusions, such as certain types of more hazardous projects, guarantees by the A/E, nuclear facilities, etc. In the face of the emergence of pollution-related claims and enormous claims related to asbestos, the insurance industry as a whole has opted to now exclude those two categories from liability insurance coverage. Those two exclusions, to be written into every new policy and renewal policies read as follows:

Pollution

We will not defend or pay under this policy for "claim" and "claim expense" resulting from "professional services" performed by you and arising out of:

1. **The actual, alleged or threatened discharge, dispersal, release or escape of "pollutants"; or**
2. **Any governmental or regulatory directive or request that "you" or anyone acting under your direction or control test for, monitor, clean up, remove contain, treat, detoxify or neutralize "pollutants".**

This exclusion does not apply to "claim" or "claim expense" resulting from "professional services" performed by you in the design and construction of treatment facilities for:

a. **domestic sewage including those receiving industrial waste but only if such industrial waste is pretreated in accordance with applicable governmental or regulatory standards,**

b. **potable water and**

c. **"storm water".**

ADDITIONAL DEFINITIONS

"Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

"Storm water" means from rain, hail, snow or sleet.

It is noted that the exceptions to the basic exclusion were initially developed by extensive discussions between the NSPE/PEPP Professional Liability Committee and representatives of CNA and the Schinnerer firm. That initial language, later revised for a clearer understanding that the exclusions would not apply to "traditional" engineering activities, such as water supply facilities, drainage, wastewater facilities, street, roads and highways, municipal incinerators, power plants and domestic and non-manufacturing facilities, was not accepted by CNA, which had meanwhile filed the language quoted above with the state insurance authorities.

As the language now stands it does not meet the concerns of engineers in private practice, but there is an indication that the more extensive and explicit language will be considered for subsequent policies. The present language is, hopefully, only a first step in better defining the extent of the exclusion, but it will take more time to learn how the exclusion will be applied through a case-by-case experience. As explained by the CNA comment in transmitting the exclusion language to policyholders, the intent is to remove from coverage claims which rest upon damage from pollution, as defined, but to continue to cover the remedial costs in the project when it is deemed that the A/E had been negligent in the design of the particular part of the facility which failed.

Asbestos

To "claim" or "claim expense" alleged to or actually arising out of:

1. **specification of a product, material or process containing asbestos**
2. **failure to detect the existence or proportion of asbestos in a product, material or process**
3. **the performance or failure to perform "professional services" in the abatement, replacement or removal of a product, material or process containing asbestos**

whether by you or on your behalf.

Indemnification

Faced with a choice of taking on a project which may entail pollution or asbestos exposures, or declining the project because of the uninsurable risks, the engineer has little choice but to seek protection through an indemnification clause. For that purpose the PEPP committee has developed two indemnification clauses as follows:

Hazardous Waste—For services involving or relating to hazardous waste elements of this agreement, it is further agreed that the OWNER shall indemnify and hold harmless ENGINEER and their consultants, agents and employees from and against all claims, damages, losses and expenses, direct and indirect, or consequential damages, including but not limited to fees and charges of attorneys and court and arbitration costs, arising out of or resulting from the performance of the work by ENGINEER, or claims against ENGINEER arising from the work of others, related to hazardous waste.

The above indemnification provision extends to claims against ENGINEER which arise out of, are related to, or are based upon, the dispersal, discharge, escape, release or saturation of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids, gases or any other material, irritant, contaminant or pollutant in or into the atmosphere, or on, onto, upon, in or into the surface or subsurface (a) soil, (b) water or water-courses, (c) objects, or (d) any tangible or intangible matter, whether sudden or not.

Asbestos—For services involving or relating to the removal or encapsulation of asbestos as part of this agreement, it is further agreed that the OWNER shall indemnify and hold harmless ENGINEER and their consultants, agents and employees from and against all claims, damages, losses and expenses, direct and indirect, or consequential damages, including but not limited to fees and charges of attorneys and court and arbitration costs, arising out of or resulting from the performance of the work by ENGINEER, or claims against ENGINEER arising from the work of others, related to asbestos activities.

Already the question has been raised as to what action the engineer should take if a particular project does not indicate the likelihood of either a pollution or asbestos concern, but during the course of the work such a potential problem develops. It would be impractical in such an instance for the engineer to unilaterally terminate services. To do so, in fact, might well generate a claim for breach of contract. One suggestion to deal with this kind of potential problem is to add a clause in the owner-engineer agreement and in supplementary general conditions to the effect that when and if such conditions are observed the engineer or the contractor, as the case may be, shall cease all work related to the pollution or asbestos conditions and notify the owner of the circumstances. The owner will then be obligated to determine what course of action is to be taken, such as bringing in experts for advice on how to deal with the condition.

Toxic and Hazardous Waste—As this report was being prepared Congress was in the midst of deliberations on an extension and expansion of the federal Superfund program. This federal program designed to bring about the cleanup of toxic and hazardous waste sites around the country is expected to involve the expenditure of somewhere between $5 and $10 billion over the next five years. The key players in this national program will obviously be engineers and contractors. Yet neither will be able to play their role in such an undertaking without any protection from claims alleging damage as a result of cleanup operations in a highly sensitive area, and particularly as such claims may entail class action suits of enormous magnitude.

Fortunately, Congress appears to be receptive to the problem and is moving toward an indemnification program whereby the federal government will "hold harmless" engineers and contractors (referred to as "response action contractors") in the pending legislation.

The Senate has already passed its Superfund bill, which authorizes EPA to hold harmless and indemnify response action contractors ". . . against such claims to the extent not covered by available insurance and to the extent that any such damages awarded do not arise out of the gross negligence, recklessness, or intentional misconduct of the contracting or subcontracting party, so long as such indemnification is in the public interest."

Likewise, three House committees have adopted similar language in their bills, which are now being merged into one bill for House action. As explained by the report of the House Judiciary Committee:

> "At present, insurance availability for response action contractors is diminishing, limits of coverage are being reduced, and premium rates are increasing by more than 50-200 percent. Insurance industry sources estimate that only 10 percent of contractors' market needs are currently being met by insurers, and that by January, 1986, no insurance will be available. The present lack of insurance is already causing a reduction in the number of qualified contractors willing to participate in Superfund cleanups. As insurance becomes increasingly unobtainable over the next year, the availability of qualified contractors could diminish to the point of being acute, and the Superfund cleanup program could come to an abrupt halt."

Assuming final congressional approval of the Superfund bill, a remaining question will be the extent to which the EPA indemnification will apply. The House Judiciary Committee report recognizes that EPA may provide "appropriate limits", to represent amounts equivalent to, but not in excess of, adequate insurance coverage, and to include deductibles. The report also refers to payment by response action contractors of a premium for the idemnification coverage and to offer it only as a supplement to available insurance, if available insurance is not adequate. Thus, following enactment of the indemnification provision it will be necessary for engineers and contractors to engage in detailed discussions with EPA to define the basis upon which indemnification will be provided.

Final congressional action of an indemnification approach will open the way for similar legislative action at the state level to cover projects which are state-financed outside of the federal program. Some efforts have been initiated at the state level along similar lines, but it will take concerted action by the state societies to press for more vigorous action during the 1986 legislative sessions. The federal approach should serve as a model to spur state action.

Private cleanup operations will likewise call for an insistence upon indemnification provisions in the engineer-owner contract.

Other Approaches

Various other ideas have been advanced as possible means of dealing with the liability conditions which confront the design professions.

These include, for example, a firm establishing a separate corporation to handle the pollution and asbestos kinds of projects. The idea would be for the separate company to be alone liable for claims in those areas. This entails several important considerations. First, from a legal standpoint, for this approach to work it must be clearly established that the separate firm is truly independent of the parent company. This means separate stockholders, separate officers and personnel, and separate financial arrangements. Otherwise it may well be argued that the separate company is no more than a "shield" to avoid liability, much as the cases in which a husband-owner transfers his assets to his wife to protect himself from liability. The courts will most likely, in such cases, apply the legal doctrine of "piercing the corporate veil."

A second important consideration is whether, even if a company is created as a truly separate entity, prospective clients will be willing to enter into contracts with a firm which presumably would have limited assets and no liability insurance.

From time to time, some engineers have chosen to "go bare" on the theory that in the absence of liability insurance they may be less likely targets for liability suits. There is some theoretical basis for this philosophy in today's climate of plaintiffs' attorneys looking for the "deep pocket". Again, it is a question of the extent to which the engineer is a gambler and is willing to take the chance that his personal assets will be subject to claim. It may be contended that this approach might work if the assets of the firm alone are at risk, and not those of the individual officer or shareholder. However, in the case of professional services it is more likely than not that those who are in responsible charge of plans and specifications which are found to be negligent will be held personally liable. For that reason the present professional liability policy covers the individuals in the firm, as well as the firm itself.

This idea is closely akin to what is called "self-insurance" a term which actually means no insurance. True, a firm may set aside part of its revenue each year into a separate fund for liability claims only, but under present tax law such set-aside funds are after tax dollars. If a firm is lucky enough to not have serious liability claims for enough years to build the self-insurance fund to a substantial amount it may be a workable scheme, but how much is enough to pay potential losses is purely speculative.

Part II of this report will deal with the broader aspects of the liability crisis, including protective legislation against injured construction worker claims, joint and several liability laws, punitive damages, restrictions on contingent fees, frivolous suit claims, pre-trial panel requirements, statutes of limitation, a new "unified risk" insurance concept, and the need for long-range tort reform.

THE LIABILITY CRISIS

PART II—Remedial Actions

The commonly used phrase in discussion of what actions might be taken to help resolve the liability crisis is "tort reform". That refers broadly to the idea that much of the problem arises from laws and judicial procedures which tend to impose ever-higher responsibilities and costs upon defendants in liability cases. Another common reference to this situation is the use of the "deep pocket" in determining who should be held liable for damages in a given situation. It is said that whereas the lawyer representing a plaintiff traditionally would first ask, "who is at fault", now will first ask "who has the money?"

An equally important perception is the attitude of the general public in being excessively lenient in dealing with the claims of persons claiming the right of recovery for damages sustained in a given situation, with much less concern for whether a particular defendant was at fault. This is a reflection of the same "deep pocket" philosophy alluded to above, but here it is even more significant because it is the members of the general public who make up the juries. Since 1970 there have been approximately 220 verdicts of more than $1 million in injury cases. Even though many of these were later reduced by the courts as excessive, those kinds of numbers attract headlines and further implant the idea of tremendous awards in cases in which the sympathy of the jury is with the injured plaintiff.

The more difficult problem in trying to cope with these kinds of developments is that remedial action may be taken to bring about a fairer and more equitable system designed to protect the rights of those with a proper claim, while at the same time limiting the current atmosphere which drives juries to grant ever-higher awards on responsible defendants, and, even worse, drives a finding of liability when not justified.

This Part of the paper, therefore, deals with various and sundry current proposals and developments designed to achieve some degree of reform in the justice system. It should be emphasized that many of these items as discussed below flow from medical malpractice cases, and to a substantial degree are less relevant to cases involving design professionals. The reason for the distinction is that in medical malpractice situations there is virtually always a claim involving death or injury. In the design professions, however, approximately 80 percent of the cases involve property damage, broadly defined. Only about 20 percent of design professions cases relate to personal injury or death, and most of those occur in connection with accidents during the construction process.

Worker Compensation Laws

Turning, then, to the construction accident situations, a move has started in two states (Oklahoma and Kansas) which gives promise of alleviating a problem in which the design professional is unfairly a victim of claims for accidents completely outside the responsibility of the engineer. In a typical case, an unshored trench (in violation of safety laws) collapses and a construction workman is killed. The widow is entitled to the benefits provided under the state workers compensation law, which are generally relatively low. This exonerates the contractor-employer from any further liability. The widow in this case then files suit against the design engineer, alleging that in some fashion the collapse was caused by the negligence of the design firm in failing to properly monitor the construction as part of its services during the construction phase. Even if the defendant engineering firm is ultimately found to not be responsible, substantial legal costs are involved and to a large extent, if not totally, are paid by the firm out of its deductible under the liability insurance policy.

To deal with this kind of "no-win" problem, Oklahoma first enacted an amendment to its workers compensation law which provides that in such instances the design professional stands in the same shoes as those of the contractor; the firm is equally not subject to suit for damages over and above the amount paid under the worker compensation law system. The only exception is if it is determined that the collapse was due to the negligence of the engineer. While this exception may open the door to the filing of a suit in the kind of example stated above it should be relatively simple to quickly prove that the engineer under his contract had nothing to do with the trench. In that connection, it is exceedingly important that the engineer's contract with the owner, plus provisions in the general conditions, make it clear that the engineer during the construction phase is not responsible for contractor's means, methods and techniques.

A copy of the Oklahoma law is reproduced in Appendix A.

Frivolous Suits

Probably every engineer who has been sued has reacted that the suit was unjustified, groundless and without merit—a frivolous suit. While it is often true that the engineer is brought into a dispute between other parties on a "shotgun" basis, it does not follow that the engineer is a victim of a truly frivolous suit. A frivolous suit does not result because a party wins the case on the merits, or is dismissed prior to trial. While there are various definitions of what constitutes a frivolous suit, the most common characteristics are that the party alleging the suit was frivolous must first be dismissed from the case or win on the merits. But that is not enough. It must also be shown that the allegations were totally without merit, a showing of bad faith or other improper motives on the part of the plaintiff.

The leading case to illustrate the difficulty if maintaining a frivolous suit (sometimes called a counter suit) involving design professionals is **Bird v. Rothman**, 627 P.2d 1097 (Ariz. 1981). In that case an architect had designed a race track in 1963. In 1976 he was sued by a woman who was injured at the track when the grandstand glass was shattered by a rock. In 1977 the architects were dismissed from the case. In 1978 he sued the woman's attorney on the ground the attorney had been negligent in failing to investigate the facts and the law before bringing the case. In finding against the architect, the court noted that a balance must be struck between freedom of access to the court and discouraging unmeritorious litigation; that the courts must be open to litigating parties without fear of subsequent prosecution for calling upon the court to decide a contested issue; that an ulterior purpose alone cannot constitute abuse of legal process, concluding:

> **"In summary, despite appellant's arguments that negligence suits, such as the underlying suit in this action, against architects and engineers have a significant impact on malpractice liability insurance rates and serve to impugn the reputation of conscientious professionals, we are persuaded that in the absence of proof of malicious prosecution on the part of the injured party or his attorney, the interest of freedom of access to the courts compels the conclusions we have reached."**

A number of the state societies have tried over the years to enact frivolous suit statutes to define the circumstances in which a successful defendant might recover his legal costs in defending an unmeritorious case. In fact, however, most states have such provisions by law or by court rules, even though the wording varies considerably. For those still pursuing this type of legislation attention is called to the wording in Rule 11 of the federal rules of civil procedure, as amended in 1983, requiring that all pleadings and motions on behalf of a party shall be signed by the attorney of record, and further providing that:

> **"The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion, or other paper is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee."**
>
> **(As amended Apr. 28, 1983, eff. Aug. 1, 1983).**

While a rule of this type, or a statute along similar lines, is proper and desirable, based upon a review of the cases over the years it is not likely that a design professional who was involved to any degree in either the design or construction phase of the project will be held entitled to the benefits of a countersuit through a frivolous suit action except upon a showing of a malicious purpose on the part of the plaintiff, or a reckless failure of the plaintiff's attorney to make even a minimal investigation of the facts before naming the design professional as a defendant.

Pre-Trial Panels

A development of potential significance in recent years has been the enactment of laws to require that in malpractice cases the party bringing the action first submit it to a panel of those with ostensible experience in the area of practice involved for a hearing and subsequent rendering of an opinion on the merits of the case.

These kinds of statutes vary considerably in detail, ranging from the composition of the panel members, procedural hearing requirements, compensation for the panel members, and, most importantly, the extent to which the panel opinion is admissible in any subsequent court proceedings.

The theory behind this kind of procedure is that if the pros and cons of the case are presented to an unbiased but knowledgeable panel of persons with some degree of expertise in the subject matter the resulting opinion may bring about a result which is acceptable to either or both parties, and thus avoid full-scale litigation. In every such instance, however, the panel opinion is not binding on either party and either may then take the case to court in the normal manner.

Most of the experience in this type of operation has been in the medical field. A number of pertinent questions have resulted from that experience. First, in several states the courts have ruled that a requirement that the case be first submitted to the panel is unconstitutional because it has a "chilling" effect on the plaintiff. That is, the plaintiff is required to go through what may amount to two full-scale proceedings, involving repetition of witnesses, attorney fees and time spent in prosecuting the case. This objection is compounded when the statute allows the panel finding to be submitted to a jury in a subsequent trial because it may unduly influence the jury's judgment of the case. In other states, however, the courts have upheld the mandatory panel procedure in medical malpractice cases on the ground that such a procedure is designed to deal with the "medical crisis" in the state.

To what extent the constitutional issue will be resolved when the concept is applied to non-medical cases remains to be seen. To date only one state—Hawaii—has enacted a similar requirement for design professionals. The first Hawaii statute was enacted in 1981 and was subsequently determined to be lacking in several major respects, following which it was amended in 1985. The full statute is included as Appendix B.

The essential features of the Hawaii law are:

1. The panel is composed of a chairperson who is familiar with tort claims settlement processes, one attorney experienced in trial practice and one design professional appointed from a list submitted by the registration board.

2. The claimant and the design professional defendant must each deposit $450 with the director of regulatory agencies.

3. The panel is required to hear the case within 30 days after the date for filing a response, and no persons other than the parties, witnesses, consultants and attorneys may be present except with the permission of the chairperson.

4. The panel hearing is informal, but witnesses and consultants may be questioned by the panel members and legal counsel. The panel may subpoena witnesses and documents.

5. Following completion of the hearing, the panel shall file a written advisory opinion with the director of regulatory agencies, who shall mail copies to all parties in the case and the professional liability insurance carrier. The panel opinion is to decide the issue of liability and the amount of damages, if any, stipulating which part of the damages are for economic loss and non-economic loss, but the panel may not recommend punitive damages.

6. The claimant may institute litigation based upon the claim only after a party to the panel hearing rejects the decision of the panel. The opinion of the panel on the issue of liability or damages may not be admitted in evidence in any subsequent trial.

7. The section requiring cooperation on the part of all parties to the case also provides that the costs of the action may be assessed against a professional liability insurance carrier or a party for failure to cooperate, even though the insurance company is not a party to the proceeding.

8. The 1985 amendment added a section permitting a judge to avoid the panel procedure if the judge determines that the subject matter in dispute is unsuitable for the panel procedure.

9. The 1985 amendment also added a section calling upon the attorney for the claimant to obtain a qualified person's opinion that there is merit to the claim, but this requirement may be avoided if the attorney is not able to obtain such consultation from qualified persons.

It is too early since the 1985 amendments to determine to what degree the Hawaii procedure may be helpful in resolving disputes. Design professionals in Hawaii have reported a lack of success under the 1981 law, and more recent reports indicate divided opinion as to whether the amended law has been useful to date.

Dispute Resolution

The federal and state courts are literally drowning in the volume of civil cases filed each year. As reported in a recent special study of the Defense Research Institute, there were approximately 240,000 cases filed in 1984 in the federal courts alone, and there are now 10 million civil cases filed in all courts annually. That number suggests the reason for the lengthy delay in bringing a case to trial and judgment, often running into many years. It is only because a vast majority of these cases are ultimately dropped or settled that the judicial system works at all.

Meanwhile, there is renewed interest in finding means to resolve disputes short of formal trials, both in the interest of time and cost. In Hamlet's famous soliloquy he noted, among other of life's problems, "the law's delay", and as far back as 1759 Edmund Burke observed that, "The contending parties find themselves more effectively ruined by the delay than they could have been by the injustice of any decision." Warren Burger, Chief Justice of the United States, has led the way in calling for alternative dispute resolution techniques, observing:

> **"We must remember that when a dispute arises there are options. I was trained with that generation of lawyers taught that the best service a lawyer could render a client was to keep the client out of court. The adversary litigation process is expensive and time-consuming; and it often leaves a trail of stress and frustration. Other alternatives represent a way to avoid litigation, yet they largely go unused."**

Arbitration

The best known system of alternative dispute resolution is arbitration, a procedure which is particularly pertinent to disputes involving design professional and construction cases.

Arbitration of disputes has existed since time immemorial, going back to the story of King Solomon's resolution of a dispute between two women who claimed parentage of a baby. And it has long been used in commercial cases. But in 1966 the design professions undertook to establish a special set of rules and procedure for construction disputes under the aegis of the American Arbitration Association. NSPE and some dozen other societies now support and participate in the oversight of a special set of Construction Industry Arbitration Rules, administered by AAA through its 26 regional offices. The Rules and explanatory material about the program may be obtained from AAA, 140 West 51st Street, New York, NY 10020.

While there is little doubt that arbitration is faster and less expensive than full-blown litigation, there are some in the design professions and among their lawyers who find it unacceptable for a variety of reasons. There has been some confusion about the nature of arbitration by reference to it as "mandatory" arbitration. It is mandatory in the sense that if the parties agree by contract to arbitrate disputes which may arise either party may invoke the arbitration provisions. The resulting decision of the arbitrators is then binding and enforceable in the court. But the parties may likewise agree to not include an arbitration provision in their agreement, and in that case it is simply not an option for dispute settlement. Some critics favor a clause which says that the parties may agree to arbitrate when a dispute arises, but realistically the chances of the parties at that point agreeing to anything are almost nil, such as the procedure to select the arbitrators, the rules to be observed, payment of costs, and a host of other details spelled out in the AAA Rules.

Among the objections offered by opponents of arbitration are that it is an informal procedure, the rules of evidence do not apply, the decision is not subject to appeal to the courts on the merits of the dispute, there is no provision for discovery of information by the parties prior to the hearing, and that, according to some, arbitrators tend to "split the difference" in the decision. The other side of the coin, of course, in response to these arguments is that the lack of legal formalities is one of the factors that makes arbitration more expeditious and less expensive, that without the arbitration decision being final and binding the procedure would be fruitless if a party could retry the case in court at double expense. One of the advantages of arbitration is that it is private, whereas a court trial is public.

One of the strongest arguments for arbitration rather than a jury trial is that the arbitrators are selected on the basis of their technical expertise in dealing with often-complex cases in a construction setting. Under the AAA procedures, the parties have the choice of reviewing a list of suggested arbitrators and striking those not desired to the point that the arbitrators are then named from the lists acceptable to both parties. It is vitally important in cases involving technical issues that the arbitrators have an adequate technical background to fully understand the issues. Members of juries, on the other hand, and judges, for that matter, are most unlikely to have that kind of knowledge and expertise.

To deal as objectively as possible with these arguments and counter-arguments, NSPE and the other participating societies in the Engineers' Joint Contract Documents Committee have included an arbitration clause in the owner-engineer agreement and in the general conditions on a separate page which may be removed without affecting the rest of the document, thus leaving it to the parties to decide in advance which way they prefer to go in handling potential disputes. Also, the arbitration clause in the owner-engineer agreement is limited to claims and counterclaims not in excess of $200,000. This figure, however, based on AAA statistics, represents some 80 percent of all claims involving design professionals. Another important aspect of the arbitration clause is a stipulation that it may not be used to join the design professional not a party to the agreement, that is, in a dispute between an owner and contractor, or contractor and subcontractor, the engineer may not be required to participate in or be bound by the arbitration result without prior consent.

Mediation

An emerging form of alternative dispute resolution is the use of mediation. This is a process, sometimes confused with arbitration, which attempts to have the parties agree to bring in a neutral third party to act as a "go between", to try to encourage and induce the parties to reach a voluntary settlement. A mediator has no authority to render a binding decision. It has been suggested that in advance of the start of a project the parties agree to name a mediator in the event disputes arise. While this has not been tried to any degree in the construction area, it is somewhat questionable whether the formal anticipation of disputes might not, in fact, generate disputes which otherwise might be settled by the parties themselves.

Another aspect of this development has been the suggestion that two functions be combined; that is, an arrangement in which the mediator first attempts to induce the parties to reach a voluntary settlement, and if that effort fails to convert his status to that of an arbitrator, with authority to render a binding decision. That concept is flawed by the fact that because the two functions are so different in concept and procedure the same person cannot serve both purposes. A primary function of a mediator is to solicit from both parties separately and confidentially their "bottom line" positions on each aspect of the dispute. If the parties know that such confidential information may be used against their interests if the mediator becomes an arbitrator the system itself will obviously fail.

The AAA has adopted "Construction Industry Mediation Rules" under the auspices of the Construction Industry Advisory Committee, including a contract clause for mediation. But this clause is not enforceable if either party refuses to mediate in good faith, in which case the clause becomes inoperative and the procedure turns to arbitration if the parties have also inserted the arbitration clause in their agreement.

Limitation of Liability

Another controversial idea in trying to deal with liability costs has been to write into the owner-engineer agreement a provision to the effect that the liability of the engineer will be limited to a stipulated amount or the amount of the engineer's fee, whichever is more. Although some engineers have indicated the acceptance of this idea by owners, it raises several difficult problems.

As noted in the Commentary accompanying the standard documents prepared by the Engineers' Joint Contract Documents Committee:

> **"The Committee also feels strongly that it is undesirable and quite unprofessional to try by standard society-endorsed contract forms to relieve Engineers from liability for improperly performing those duties and responsibilities which their expertise and professional training qualifies them to perform and which, because of their being licensed to practice, they have a duty to the public to perform. In fact, such contractual endeavors may well provide no more than illusory legal protection since courts and juries are not likely to accept wholesale efforts to avoid professional responsibilities."**

To date there have not been definitive court decisions applying to specific limitation of liability clauses for design services, but in several cases involving professional services the courts have held such clauses to be in violation of public policy. In some instances the courts have upheld limitation of liability clauses for commercial transactions, provided that the parties were of relatively equal bargaining strength. But in other instances where it has been determined that the contract was a "contract of adhesion", meaning it was prepared on a "take it or leave it" basis, the courts have ruled such a provision invalid.

Another facet for consideration is the reaction of clients when presented with a provision which, in effect, asks the client to share in paying the damages resulting from the negligence of the engineer. Some engineers have reported an adverse reaction to the point of endangering their retention for the job.

Unified Risk Insurance

Approximately one-third of professional liability insurance dollars go to the payment of litigation, including investigations, expert witnesses and appeals.

Suppose it were possible to find a way to eliminate most of the litigation cost? A novel and intriguing idea to accomplish that goal has been advanced and is under study by a joint committee of the professional societies. The idea, which has a long way to go before it will be known if it is feasible, is called "unified risk insurance". In brief, it contemplates that there would be one insurance policy covering the entire risk of the parties involved in the project—owner, design professional, prime contractor, subcontractors, and perhaps material suppliers. The owner would pay the entire premium on the justification that in the long run the owner pays all the costs through fees and construction bids which must reflect the cost of insurance.

Under this approach as a liability issue arose there would not be an attempt, as now, to decide which party was at fault. The single insurance fund would pay the cost of remedial action. It has been compared to home fire insurance. If there is a fire it does not matter from an insurance standpoint whether it was caused by smoking in bed, bad electrical wiring, lightning, or any other cause. The insurance pays the cost of restoring the property to its original state. In a word, it is a form of "no fault" insurance.

There are some obvious questions and limitations. It could not cover non-property claims between the parties, such as a contractor claim for an extra because another party had delayed his performance. That kind of claim would have to be resolved by arbitration or litigation. It could conceivably cover claims by injured third persons, but those kinds of claims could involve litigation to determine if the injury was caused by any of the covered parties, and, if so, the amount of damages.

The idea basically is to have three related insurance policies—one for property damage in the project (the walls crack, there is roof leakage, the HVAC system does not work, and a host of other typical property claims). A second policy would cover third-party claims of the type noted above. And a third policy would extend the coverage to an undefined period of years following completion of the project. One of the many unresolved issues at this point is whether and to what extent there would be deductibles for the various parties, and how they would be allocated.

The insurance consultant retained by the societies to develop the idea has noted that in today's insurance market it would be most difficult to launch such a revolutionary approach, and it is likely that the insurance industry would require, at best, some form of "stop loss" fund to protect the insurance underwriters; an in-house or captive insurance fund raised by the participating societies.

The current status is that the idea is being explored in depth with representatives of the insurance industry, owners, contractors, subcontractors, and others. Realistically, it will be several years before there is any definitive conclusion as to the merits and feasibility of such an approach to reduction of liability insurance costs.

Statute of Limitations

A more immediate remedial provision is the enactment of statutes of limitation, more correctly identified as statutes of repose. These kinds of state laws, which exist in more than half of the states today, provide that after a stated period of time following substantial completion of the project (usually 6-8 years) a person claiming injury as a result of faulty design or related services is barred from maintaining an action against the design professional. Appendix C lists the states with such statutes and the applicable time period.

In some states, as noted, the courts have held these statutes to be unconstitutional in that they deprive an injured party of his "day in court", although in each such state law it is provided that the bar to suit does not apply to the owner or person in possession of the property. That party is more justifiably accountable for a failure which occurred long after the project was designed and built by virtue of inadequate maintenance of the facility.

The existing statutes of repose vary in detail and should be read in entirety to determine the starting period for the time cut-off, the parties covered by the law and the interpretation of the law by the courts.

Contingent Fees

An area of tort reform drawing considerable attention as the overall liability situation has worsened is the use (or abuse) of contingent fees by lawyers. It is alleged that this system of allowing lawyers to collect substantial fees as a percentage of awards to injured persons generates claims, and there is little doubt that this is true. As a result, several states have now moved to put a limit on contingent fees on a reduced sliding scale. A recent New York law, for example, stipulates that contingent fees will be limited to 30 percent of the first $250,000 recovered, 25 percent of the next $250,000, 20 percent of the next $500,000, 15 percent of the next $250,000, and 10 percent of any amount over $1,250,000.

The contingent fee system relates almost exclusively to injury or death claims, and is therefore of less importance to design professionals than to those in the medical field. However, as previously noted, a limitation schedule of the New York type will be helpful to some extent to engineers in the 20 percent of cases involving bodily injury or death.

A related aspect of this point is the suggestion that one of the major deterrents to unjustified suits would be to adopt the so-called "English Rule" in which the losing party is required to pay the legal costs of the prevailing party. The "American System", to the contrary, has always called upon the parties to pay their own legal costs no matter the outcome. The American Rule has been eroded to a considerable extent in recent years in special types of litigation, such as violation of civil rights, environmental cases, and others in which the legislature has determined that there are special considerations justifying a form of "penalty" on those who violate basic rights of others. But in the design field, and in commercial cases generally, the American Rule still holds.

The "other side of the coin" in considering a change to the English Rule, however, is that it cuts both ways. If the design professional is held to have been negligent he would have to pay the legal costs of the plaintiff.

Punitive Damages

Engineers and other design professionals have rarely been subjected to punitive damages, i.e., sometimes called "smart damages", meaning that the offending party has acted in such a grievous manner that he should feel the sting of his dereliction by having to pay a penalty on top of actual damages. This has become a major concern in injury and death cases, often resulting in enormous awards far exceeding actual economic loss, i.e. loss of wages, medical costs, loss of use of property, etc. The Defense Trial Lawyers' Task Force on Litigation Cost Containment has proposed that punitive damages be eliminated entirely, or at least severely restricted in light of its abuse in recent years.

Richard K. Willard, Assistant Attorney General, Civil Division, Department of Justice, has observed:

> "Another remarkable development in tort actions between private parties is that awards of punitive damages have increased dramatically. Punitive damages were originally intended to punish particularly egregious or malicious conduct. Such damages may have a place in a system bottomed on fault. One would therefore expect that as the tort system moved away from fault, punitive damage awards would become rarer. Instead, the incidence and size of punitive awards seem to be increasing.
>
> If this trend toward massive increases in punitive and noneconomic damages continues, its impact on the economy of this nation is likely to be devastating."

Pain and Suffering

A closely related aspect of the drive for tort reform is huge awards for pain and suffering. This has reached the point of bringing about corrective legislative action in some states. The most notable action along this line was the enactment in California of a flat $250,000 maximum limitation in medical malpractice actions for "non-economic losses to compensate for pain, suffering, inconvenience, physical impairment, disfigurement, and other non-pecuniary damage."

The statute was promptly challenged on constitutional grounds, but was upheld by the California Supreme Court. **Fein v. Permanente Medical Group**, 695 P. 2d 665 (1985). An appeal was taken to the U.S. Supreme Court, which dismissed the appeal "for want of a substantial federal question," without written opinion. That type of rejection by the Supreme Court is a decision on the merits, suggesting that a number of other states may well follow the California precedent now that the Supreme Court has found no constitutional objection at the federal level. However, the issue is far from being finally resolved. Justice Byron White, the lone dissenting member of the Supreme Court, opined that the Court should have taken the case for full review because other state courts have rejected similar limits. Justice White predicted, in effect, that the issue will eventually be back before the Supreme Court as more states enact similar limitations.

The issue more directly impacts the medical profession, but is nevertheless significant for the design professions if the trend for a larger share of design cases to involve bodily injury or death continues.

Joint and Several Liability

If a case involves several defendants, which is not unusual in construction industry operations, and if judgment is rendered against all the defendants the state law may make each defendant fully liable for the total judgment, even if a particular defendant was only negligent to a small degree. Thus, the doctrine of joint and several liability, poses serious dangers to design professionals caught up in a multi-defendant case. Suppose that the engineer was only 5 percent negligent, and the contractor, subcontractor, owner, or other liable parties are no longer in business, or have been adjudged bankrupt, or have inadequate assets to pay their share. The engineer in that situation is liable for the entire award.

Various tort reform groups are now pushing for a change in the state laws to eliminate the joint and several doctrine and require that each defendant pay its fair share to the degree it contributed to the damage. The alternative to joint and several, or course, is the doctrine of comparative negligence. This means, of course, that in a particular situation the plaintiff may not collect the full award if one or more of the co-defendants is "judgment proof", but that is a risk that the plaintiff should share in bringing the action in the first place. The obverse argument to the effect that no matter the plaintiff must be "made whole" at the expense of another, even if unfairly, reflects what is perhaps the most basic cause of all of the liability crisis—that we want to live in a risk-free society. But the real issue is not whether we can achieve the impossible of a "risk-free" society, rather how to most fairly allocate those risks.

Structured Settlements

Another area of tort reform much to be desired is a requirement for structured settlements in the case of very large awards. Again, this pertains mainly to injury and death awards. If the award is required to be paid in one lump sum it amounts to much more than the amount of the award in that the large amount is invested and over a period of years may amount to twice or more the original amount. This kind of case arises mainly when an injured person needs a substantial sum each year for an indefinite period to pay for housing, food, nursing care, special equipment, etc. Under a structured settlement arrangement the amount of the award is not changed, but is payable over the years, which means that the liable defendant may put a considerably lesser sum in some form of trust or escrow account to provide the required amount each year, probably adjusted for inflation.

The arrangement is much like the case in which the winner of a state lottery wins a million dollars. In fact, the winner does not receive a lump sum of one million dollars. Rather, he more likely receives $50,000 a year for 20 years, and the state deposits whatever lesser amount is required in a special account to provide that amount out of principal and interest.

Collateral Source Rules

When a judgment is made in favor of an injured plaintiff the jury is required to then ascertain the amount of damages and the amount to be awarded. But the jury is not advised of the amounts which may be received by the plaintiff from other sources, such as worker compensation benefits, private insurance, employer payments, and the like. Thus, the jury is left in the dark in calculating the amount of damages to be awarded in terms of offsetting benefits related to the injury. This so-called "collateral source rule", which prohibits the defendant from offering evidence of other benefits, serves to give the plaintiff additional benefits over and above those determined by the jury.

The basic concept of money damages for one injured by the negligence of another is to reach a result which is said to "make the plaintiff whole", that is, to compensate the injured party for "out-of-pocket" losses (leaving aside here the issue of punitive damages, discussed above).

Several of the state liability reform studies have accordingly recommended that the collateral source rule should be repealed so that a more equitable result will occur for both parties, thereby reducing the impact of liability awards and related insurance costs without penalizing the plaintiff.

In-House Controls

Although it has been said and written **ad nauseam**, the single best thing an engineer can do to limit, if not avoid, liability claims is to exercise tight control over in-house operations, use legally and technically sound documents, monitor on-site functions of assigned personnel during the construction phase, and, in general, approach every project with one eye on the liability potential.

Among the tools available for general guidance and assistance are the NSPE/PEPP "Architect-Engineer Quality Control Manual", (NSPE Pub. No. 1957), the NSPE/PEPP "Office Policy Handbook", (NSPE Pub. No. 1967), and a 60-minute video seminar entitled "Professional Liability".

Also, as previously mentioned, the Engineers' Joint Contract Documents Committee has over the years developed a set of documents which attempt to provide contract terms which are fair to the engineer, the owner and the contractor. (Appendix D).

There are numerous other sources of information from other societies, private publishers and public agencies which may be helpful. It is recognized that an engineer cannot spend all his time on a project with the only emphasis on liability exposure, but to a reasonable degree the extent to which the liability possibilities are kept in mind and in balance with technical and managerial functions the engineer will be well served.

The Coalition Approach

Part of this special report deals with action items engineering and related societies can tackle on their own, but hopefully with the support of other interested groups. A larger part of the problem areas, particularly those identified as tort reform, will require involvement in broader coalitions of other professions and public groups, such as organizations of municipalities and private concerns hard hit by the liability crisis.

A number and variety of tort reform coalitions are developing around the country. Some of these have been authorized by state legislation, others by action of the governor. The private groups range from manufacturers concerned with product liability, to state chambers of commerce, and to attorney groups, both from the standpoint of defense attorneys and trial lawyers who are the natural opponents of tort reform. NSPE has organized a liability task force to monitor developments at the national level and to cooperate with state groups. It behooves each state society to ascertain the status of these developments in the state, and to participate to the extent possible with such coalitions or separate reform groups in order that the views of the engineering profession are expressed as the campaign for tort reform progresses. It is particularly important that the state societies make early contact with state-sponsored liability study groups and seek appointment of at least one engineer in such bodies.

In the final analysis, every group involved in the reform movement has agreed that the greatest success can be achieved only if the general public is made aware of the issues and the need for corrective action. This is happening already to a considerable extent as child care clinics close, municipalities "go out of business", for lack of insurance or face enormous tax increases to pay the higher premiums, as obstetricians cease practice, as hospital rates soar, and so on down the line. As the general public is made award of the problem, and particularly comes to understand that the ultimate losers are those who pay the taxes and the increased cost of products and services, the opportunity for improvement in the legal justice system will emerge.

In this connection, a potentially significant development has occurred at the federal level with the announcement by Attorney General Edwin Meese of the appointment of an interagency Tort Policy Working Group. This federal group, under the direction of Assistant Attorney General Richard K. Willard, head of the Civil Division, who has spoken out strongly on the need for tort reform, will consider a broad range of policy issues that relate to the current crisis of the tort system.

The federal interagency group is intended to recommend legislative, regulatory and litigative proposals at the federal level. Although the major scene of action in tort reform must occur at the state level, the eventual report of the federal group will not only serve to present specific proposals, but, more importantly, will be a key factor in bringing to the attention of the public the need for action.

AN ACT RELATING TO WORKERS' COMPENSATION; AMENDING 85 O.S. 1981, SECTION 12, AS AMENDED BY SECTION 1, CHAPTER 37, O.S.L. 1982 (85 O.S. SUPP. 1983, SECTION 12); PROVIDING PROCEDURES RELATING TO EXCLUSIVE LIABILITY, EXCEPTIONS, COURT ACTIONS, AND IMMUNITY INCLUDING PERSONS TO WHICH LIMITED LIABILITY APPLIES TO.

BE IT ENACTED BY THE PEOPLE OF THE STATE OF OKLAHOMA:

SECTION 1. AMENDATORY 85 O.S. 1981, Section 12, as amended by Section 1, Chapter 37, O.S.L. 1982 (85 O.S. Supp. 1983, Section 12), is amended to read as follows:

Section 12. The liability prescribed in Section 11 of this title shall be exclusive and in place of all other liability of the employer and any of his employees, any architect, professional engineer, or land surveyor retained to perform professional services on a construction project, at common law or otherwise, for such injury, loss of services, or death, to the employee, or the spouse, personal representative, parents, or dependents of the employee, or any other person. If an employer has failed to secure the payment of compensation for his injured employee, as provided for in this title, an injured employee, or his legal representatives if death results from the injury, may maintain an action in the courts for damages on account of such injury, and in such action the defendant may not plead or prove as a defense that the injury was caused by the negligence of a fellow servant, or that the employee assumed the risk of his employment, or that the injury was due to the contributory negligence of the employee; provided:

(i) The immunity created by the provisions of this section shall not extend to action by an employee, or the spouse, personal representative, parents, or dependents of the employee, or any other person against another employer, or its employees, on the same job as the injured or deceased worker where such other employer does not stand in the position of an intermediate or principal employer to the immediate employer of the injured or deceased worker;

(ii) The immunity created by the provisions of this section shall not extend to action against another employer, or its employees, on the same job as the injured or deceased worker even though such other employer may be considered as standing in the position of a special master of a loaned servant where such special master neither is the immediate employer of the injured or deceased worker nor stands in the position of an intermediate or principal employer to the immediate employer of the injured or deceased worker; and

(iii) This provision shall not be construed to abrogate the loaned servant doctrine in any respect other than that described in paragraph (ii) of this section. This section shall not be construed to relieve the employer from any other penalty provided for in this title for failure to secure the payment of compensation provided for in this title.

(iv) For the purpose of extending the immunity of this section, any architect, professional engineer, or land surveyor shall be deemed an intermediate or principal employer for services performed at or on the site of a construction project, but this immunity shall not extend to the negligent preparation of design plans and specifications.

RELATING TO DESIGN PROFESSIONAL CONCILIATION PANEL.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Chapter 672, Hawaii Revised Statutes, is amended by adding two new sections to read as follows:

"§-672 Determination of unsuitability. Any party or any person served with notice of a claim may file a motion with circuit court in the judicial circuit in which the claim arose for a determination that the subject matter of the dispute is unsuitable for review by a panel under this chapter; provided that no such application may be filed within ten days of the date on which the claim is scheduled to be heard by a panel or after such a hearing has taken place.

In determining whether the subject matter of a dispute is unsuitable for disposition pursuant to this chapter, a court may consider:

(1) The magnitude of the potential award, or any issue of broad public concern raised by the subject matter underlying the dispute;

(2) Problems referred to the court where court regulated discovery is necessary;

(3) The fact that the matter in dispute is a reasonable or necessary issue to be resolved in pending litigation and involves other matters not covered by or related to this chapter;

(4) The fact that the design professional's involvement in the matter is distinctly secondary in importance to the involvement of parties not covered by this chapter;

(5) The potential for unreasonable delays in reaching any resolution of the matter by its referral to a panel pursuant to this chapter; or

(6) The fact that there are too many parties or issues involved to be effectively handled by the informal processes of this chapter.

Any such application to the circuit court shall be made and heard in a summary manner and in accordance with procedures for the making and hearing of motions.

§672- Certificate of consultation. (a) any claim filed under this chapter shall be accompanied by a certificate which declares one of the following:

(1) That the attorney has reviewed the facts of the case, that the attorney has consulted with at least one design professional who is licensed to practice and practices in this State or any other state, or who teaches at an accredited college or university and is licensed to practice in this State or any other state, in the same discipline as the design professional against whom the claim is made and who the attorney reasonably believes is knowledgeable in the relevant issues involved in the particular action, and that the attorney has concluded on the basis of such review and consultation that there is a reasonable and meritorious cause for the filing of the claim. The persons consulted may not be a party to the case;

(2) That the attorney was unable to obtain the consultation required by paragraph (1) because a statute of limitations would impair the action and that the certificate required by paragraph (1) could not be obtained before the impairment of the action. If a certificate is executed pursuant to this paragraph, the certificate required by paragraph (1) shall be filed within thirty days after filing the claim; or

(3) That the attorney was unable to obtain the consultation required by paragraph (1) because the attorney has made three separate good faith attempts with three separate design professionals to obtain such consultation and none of those contacted would agree to such a consultation.

(b) Where an attorney intends to rely solely on a failure to inform of the consequences of a procedure, this section shall be inapplicable. The attorney shall certify upon filing of the claim that the attorney is relying solely on the failure to inform of the consequences of a procedure and for that reason is not filing a certificate as required by this section.

(c) For the purposes of this section, the attorney shall not be required to disclose the names of design professionals consulted to fulfill the requirements of subsection (a).

(d) Unless a certificate is filed pursuant to subsection (a) or (b), the claim shall not be received for filing by the department."

SECTION 2. Section 672-1, Hawaii Revised Statutes, is amended to read as follows:

"§672-1 Definitions. For the purposes of this chapter:

"Design professional" means a professional engineer, architect, surveyor or landscape architect.

"Entities employing design professionals" means professional corporations or other business structures under which design professionals may practice and does not include non-design professional entities."

SECTION 3. Section 672-2, Hawaii Revised Statutes, is amended to read as follows:

"§672-2 Actions against architects, professional engineers, surveyors, and landscape architects. In any action for damages arising out of the alleged professional negligence of actions performed in the professional practice of a person holding a license as a professional engineer, architect, surveyor, or landscape architect under chapter 464, before the time of filing the complaint, the aggrieved person shall file a claim with the design professional conciliation panel.

SECTION 4. Section 672-3, Hawaii Revised Statutes, is amended to read as follows:

"§672-3 Design professional conciliation panel; composition, selection, compensation. (a) There are established conciliation panels which shall review and render findings and advisory opinions on the issues of liability and damages in tort claims against professional architects, engineers, surveyors, and landscape architects.

(b) A design professional conciliation panel, hereafter called "the panel", shall be formed for each claim filed pursuant to section 672-4 and after each panel renders its decision or the claim is otherwise disposed of it shall be disbanded. Each design professional conciliation panel shall consist of one chairperson selected from among persons who are familiar with and experienced in the tort claims settlement process, one attorney licensed to practice in the courts of the State and experienced in trial practice, and one architect, engineer, surveyor, or landscape architect licensed to practice under chapter 464. The chairperson shall be appointed by the chief justice of the supreme court of Hawaii. The attorney shall be appointed by the chairperson from a list of not less than thirty-five attorneys experienced in trial practice submitted annually by the supreme court. The architect, engineer, surveyor, or landscape architect shall be appointed by the chairperson from a list of not less than thirty-five design professionals submitted annually by the board of registration of professional engineers, architects, surveyors, and landscape architects.

The chairperson shall preside at the meetings of the panel. The chairperson and all panel members shall be compensated at the rate of $300 per claim handled which will become payable when the decision of the panel is submitted and shall be paid allowances for travel and living expense which may be incurred as a result of the performance of their duties and they shall be paid by the department of commerce and consumer affairs from funds collected from the claimant and defendant, to be shared equally. The claimant shall deposit $450 with the department upon the filing of the claim and the failure to do so shall result in the claim being rejected for filing. The design professional shall deposit $450 with the department within twenty days of being served with the claim and the failure to do so shall result in termination of proceedings under this chapter allowing the claimant to proceed in accordance with section 672-8. If the claim is withdrawn, determined to be unsuitable for proceedings under this chapter, or otherwise terminated without participation by a panel, the department shall return all moneys collected to the respective parties.

The office and meeting space, secretarial and clerical assistance, office equipment and office supplies for the board shall be furnished by the department of commerce and consumer affairs.

The board of registration shall prepare a list of architects, engineers, surveyors, and landscape architects along with their respective specialties who shall then be considered consultants to the panel in their respective fields. Panel members may consult with other legal, technical, and insurance specialists. Any consultant called by the panel to appear before the panel shall be paid an allowance for travel and living expenses which may be incurred as a result of such person's appearance before the panel. Such costs shall be paid by the department of commerce and consumer affairs."

SECTION 5. Section 672-4, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) Any person or his representative claiming that a tort has been committed by the design professional or entities employing such design professionals shall file a claim with the department of commerce and consumer affairs before a suit based on the claim may be commenced in any court of the State. All claims shall be submitted to the department of commerce and consumer affairs in writing on forms provided by the department. If the claim is presented orally, the department of commerce and consumer affairs shall reduce the claim to writing. The claimant shall set forth facts upon which the claim is or may be based and shall include the names of all parties against whom the claim is or may be made who are known to the claimant. Within five business days thereafter, the panel shall give notice of the claim, by certified mail, to all architects, engineers, surveyors, or landscape architects and others who are or may be parties to the claim and shall furnish copies of written claims to such persons. Such notice shall set forth a date, not more than twenty days after mailing the notice, within which any design professional against whom a claim is made may file a written response to the claim, and a date and time, not less than five days following the date for filing a response, for a hearing of the panel. Such notice shall describe the nature and purpose of the panel's proceedings and shall designate the place of the hearing. The times originally set forth in the notice may be changed by the chairman, on due notice to all parties, for good cause; provided that a party requesting the rescheduling of the hearing within seven days of the scheduled date shall be required in the sole discretion of the panel chairperson to additionally compensate the panel in an amount equal to the fee panel members receive pursuant to section 672-3."

SECTION 6. Section 672-5, Hawaii Revised Statutes, is amended to read as follows:

"§672-5 Design professional conciliation panel hearing; fact-finding; evidence; voluntary settlement. Every claim of a tort shall be heard by the design professional conciliation panel within thirty days after the date for filing a response. No persons other than the panel, witnesses, and consultants called by the panel, and the persons listed in section 672-6 shall be present except with the permission of the chairperson. The panel may, in its discretion, conduct an inquiry of a party, witness, or consultant without the presence of any or all parties.

The hearing shall be informal. The panel may require a stenographic record of all or part of its proceedings for the use of the panel, but such record shall not be made available to the parties. The panel may receive any oral or documentary evidence. Questioning of parties, witnesses, and consultants may be conducted by the panel, and the panel may, in its discretion, permit any party, or any counsel for a party to question other parties, witnesses or consultants. The panel may designate who, among the parties, shall have the burden of going forward with the evidence with respect to such issues as it may consider, and unless otherwise designated by the panel, when the design professional's records have been provided to the claimant for the claimant's proper review, such burden shall initially rest with the claimant at the commencement of the hearing.

The panel shall have the power to require by subpoena the appearance and testimony of witnesses and the production of documentary evidence. When such subpoena power is utilized, notice shall be given to all parties. The testimony of witnesses may be taken either orally before the panel or by deposition. In cases of refusal to obey a subpoena issued by the panel, the panel may invoke the aid of any circuit court in the State, which may issue an order requiring compliance with the subpoena. Failure to obey such order may be punished by the court as a contempt thereof. Any member of the panel may sign subpoenas, administer oaths and affirmations, examine witnesses, and receive evidence. Notwithstanding such powers, the panel shall attempt to secure the voluntary appearance, testimony, and cooperation of parties, witnesses, and consultants without coercion.

At the hearing of the panel and in arriving at its opinion the panel shall consider, but not be limited to, statements or testimony of witnesses, construction documents, inspection reports, calculations, and other records kept in the usual course of the practice of the design professional without the necessity for other identification or authentication, statements of fact or opinion on a subject contained in a published treatise, periodical, book or pamphlet, or statements of experts without the necessity of the experts appearing at the hearing. The panel may upon the application of any party or upon its own decision appoint as a consultant, an impartial and qualified architect, engineer, surveyor, or landscape architect or other professional person or expert to testify before the panel or to conduct any necessary professional of expert examination of the claimant of relevant evidentiary matter and to report to or testify as a witness thereto. Such a consultant shall not be compensated or reimbursed except for travel and living expenses which may be incurred as a result of such person's appearance before the panel. Such expenses shall be paid by the department of commerce and consumer affairs to be paid as provided in Section 672-3. Discovery by the parties shall not be allowed.

During the hearing and at any time prior to the rendition of an advisory decision pursuant to section 672-7, the panel may encourage the parties to settle or otherwise dispose of the case voluntarily."

SECTION 7. Section 672-10, Hawaii Revised Statutes, is amended to read as follows:

"§672-10 Statute of limitations tolled. The filing of the claim with the design professional conciliation panel shall toll any applicable statute of limitations, and any such statute of limitations shall remain tolled until sixty days after the date the decision of the panel is mailed or delivered to the parties; provided that in no case shall the applicable statute of limitations be tolled for more than twelve months. If a decision by the design professional conciliation panel is not reached within twelve months, the statute of limitations shall resume running and the party filing the claim may commence a suit based on the claim in any appropriate court of this State. The panel shall notify in writing all parties of this provision."

SECTION 8. Section 672-11, Hawaii Revised Statutes, is amended to read as follows:

"§672-11 Duty to cooperate; assessment of costs and fees. It shall be the duty of every person who files a claim with the design professional conciliation panel, every architect, engineer, surveyor, or landscape architect against whom such claim is made, to cooperate with the design professional conciliation panel for the purpose of achieving a prompt, fair, and just disposition or settlement of such claim, provided that such cooperation shall not prejudice the substantive rights of said persons.

After trial of such claim or after settlement of such claim after suit has been filed, any party may apply to the court in which the suit was brought to have the costs of the action assessed against any party or any insurance carrier or any other person providing professional liability insurance to a party design professional or both, for failure to cooperate with the design professional conciliation panel. The court may award such costs, or a portion thereof, including attorney's fees, witness fees, including those of expert witnesses, costs of discovery and transcribing depositions, and court costs to the party applying therefor.

On application of the director of commerce and consumer affairs, the court may award as a civil penalty against any party or any insurance carrier or other person providing professional liability insurance to a party design professional, or all or any combination of such persons, all or a portion of the costs and expenses of the design professional conciliation panel attributable to a claim involving such persons, if the court finds that such person or persons failed to cooperate with the design professional conciliation panel. Such penalty shall be payable to the general fund.

In determining whether any person has failed to cooperate in good faith, the court shall consider, but is not limited to, the following:

(1) The attendance of the persons at the hearing of the design professional conciliation panel;
(2) The extent to which representatives of the parties and counsel representing parties came to panel hearings with knowledge of the claims and defenses and authority to negotiate a settlement or other disposition of the claim;
(3) The testimony of members of the panel as to the facts of the person's participation in the panel hearing;
(4) The extent of the person's cooperation in providing the panel with documents and testimony called for by the panel; and
(5) The reasons advanced by the person so charged for not fully cooperating or negotiating."

SECTION 9. Section 672-14, Hawaii Revised Statutes, is amended to read as follows:

"§672-14 Retroactive application. This chapter shall apply to any claim arising prior to June 22, 1981 if a suit based on the claim has not been filed in a court of competent jurisdiction prior to that date."

Appendix C

Statutes of Limitation for the Design Professionals

(Note—**boldface** *indicates a statute subsequently held unconstitutional*)

STATE	DATE ADOPTED	NUMBER OF YEARS AFTER SUBSTANTIAL COMPLETION OR OCCUPANCY
Alabama	**1969**	**Seven (Latent Defects)** **Four (Patent Defects)**
Alaska	1967	Six
Arizona	—	No statute
Arkansas	1967	Five (Property Damage) Four (Personal Injury)
California	1971	Ten (Latent Defects) Four (Patent Defects)
Colorado	1979	Ten
Connecticut	1969	Seven
Delaware	1974	Six
District of Columbia	1972	Ten
Florida	1980	Fifteen (Latent Defects) Four (Patent Defects)
Georgia	1968	Eight
Hawaii	**1974**	Six
Idaho	1965	Six
Illinois	**1982**	**Twelve**
Indiana	1967	Ten
Iowa	—	No Statute
Kansas	1963	Ten (Latent Defects) Two (Patent Defects)
Kentucky	**1966**	**Five**
Louisiana	1964	Ten
Maine	1975	Ten
Maryland	1979	Ten
Massachusetts	1968	Six
Michigan	1967	Six
Minnesota	1980	Fifteen
Mississippi	1966	Ten
Missouri	1976	Ten
Montana	1971	Ten

Nebraska	1972	Ten
Nevada	1965	Six
New Hampshire	**1965**	**Six**
New Jersey	1967	Ten
New Mexico	1967	Ten
New York	1963	Three
North Carolina	1963	Six
North Dakota	1967	Ten
Ohio	1963	Ten
Oklahoma	1978	Ten
Oregon	1971	Ten
Pennsylvania	1965	Twelve
Rhode Island	1975	Ten
South Carolina	**1970**	**Ten**
South Dakota	**1966**	**Ten**
Tennessee	1965	Four
Texas	1975	Ten
Utah	1967	Seven
Vermont	1959	Six
Virginia	1964	Five
Washington	1967	Six
West Virginia	1983	Ten
Wisconsin	1976	Six
Wyoming	**1973**	**Ten**

Appendix D

ORDER FORM PEPP

TO: NSPE/PEPP
P.O. Box 35023
Washington, D.C. 20013

Send to the undersigned the indicated quantity of Contract Documents — Check enclosed in the amount of $ ________________

NSPE Publication No.	Title	Quantity	Price
1910-1	Standard Form of Agreement between Owner and Engineer for Professional Services (1984 ed.)	________	$2.00 10 or more $1.00 ea.
1910-1-A	Suggested Listing of Duties, Responsibilities and Limitations of Authority of Resident Project Representative (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-2	Standard Form of Letter Agreement between Owner and Engineer for Professional Services (1985 ed.)	________	$1.00 10 or more 50¢ ea.
1910-8	Standard General Conditions of the Construction Contract (1983 ed.)	________	$2.00 10 or more $1.00 ea.
1910-8-A-1	Standard Form of Agreement between Owner and Contractor on the Basis of a Stipulated Price (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-8-A-2	Standard Form of Agreement between Owner and Contractor on the Basis of Cost-Plus (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-8-B	Change Order (1983 ed.) — Pads of 25	________	$2.00 per pad
1910-8-D	Certificate of Substantial Completion (1983 ed.) Pads of 25	________	$2.00 per pad
1910-8-E	Application for Payment (1983 ed.) — Pads of 25	________	$2.00 per pad
1910-8-F	Work Directive Change (1983 ed.) — Pads of 25	________	$2.00 per pad
1910-9	Commentary on Agreements for Engineering Services and Contract Documents by John R. Clark, Esq. (1981 ed.)	________	$10.00 No bulk rate
1910-9-A	Commentary on 1983 Editions of Construction Related Documents by John R. Clark, Esq. (1983 ed.)	________	$5.00 No bulk rate
1910-9-B	An Update to Indicate Important Changes in EJCDC Standard Agreements for Engineering Services (1984 ed.)	________	$5.00 No bulk rate
1910-9-C	Focus on Shop Drawings by John R. Clark, Esq. (1985 ed.)	________	$15.00 No bulk rate
1910-10	Standard Form of Agreement between Engineer and Architect for Professional Services (1985 ed.)	________	$2.00 10 or more $1.00 ea.
1910-11	Cross Reference between EJCDC Standard General Conditions of the Construction Contract (1910-8, 1983 ed.) and AIA General Conditions of the Contract for Construction (No. A201, Aug. 1976 ed.) (1984 ed.)	________	$1.00 No bulk rate
1910-12	Guide to the Preparation of Instructions to Bidders (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-13	Standard Form of Agreement between Engineer and Associate Engineer for Professional Services (1985 ed.)	________	$2.00 10 or more $1.00 ea.
1910-14	Standard Form of Agreement between Engineer and Consultant for Professional Services (1985 ed.)	________	$2.00 10 or more $1.00 ea.
1910-15	Standard Form of Agreement between Owner and Project Manager for Professional Services (1977 ed.)	________	$2.00 10 or more $1.00 ea.
1910-16	Uniform Location of Subject Matter (1981 ed.)	________	$2.00 10 or more $1.00 ea.
1910-17	Guide to the Preparation of Supplementary Conditions (1983 ed.)	________	$5.00 No bulk rate
1910-18	Suggested Bid Form and Commentary for Use (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-19	Standard Form of Agreement between Owner and Engineer for Study and Report Professional Services (1985 ed.)	________	$2.00 10 or more $1.00 ea.
1910-20	Engineer's Letter to Owner Requesting Instructions re Bonds and Insurance During Construction (1985 ed.)	________	$1.00 10 or more 50¢ ea.
1910-21	Owner's Instructions to Engineer re Bonds and Insurance During Construction (1983 ed.)	________	$1.00 10 or more 50¢ ea.
1910-22	Notice of Award (1983 ed.) — Pads of 25	________	$2.00 per pad
1910-23	Notice to Proceed (1983 ed.) — Pads of 25	________	$2.00 per pad
1910-24	Contract Documents Bibliography (1984 ed.)	________	$1.00 No bulk rate
1910-25	Commentary on AIA C141 Standard Form of Agreement between Architect and Engineer, June 1979 (1981 ed.)	________	$3.00 No bulk rate
1910-26-A	Standard Form of Procurement Agreement between Owner and Contractor (1981 ed.)	________	$2.00 10 or more $1.00 ea.
1910-26-B	Procurement General Conditions (1981 ed.)	________	$3.00 10 or more $1.50 ea.
1910-26-C	Guide to the Preparation of Procurement Supplementary Conditions (1981 ed.)	________	$3.00 10 or more $1.50 ea.
1910-26-D	Instructions to Bidders for Procurement Contracts (1981 ed.)	________	$2.00 10 or more $1.00 ea.
1910-26-E	Commentary on Procurement Documents by John R. Clark, Esq. (1981 ed.)	________	$2.00 10 or more $1.00 ea.
1910-28-A	Construction Performance Bond (1984 ed.) — Pads of 25	________	$2.00 per pad
1910-28-B	Construction Payment Bond (1984 ed.) — Pads of 25	________	$2.00 per pad
	Complete set of documents (does not include full pads; single document copies only)	________	$80.00
	Binder; 3-ring	________	$10.00
	Complete set of documents with binder	________	$90.00

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December 1985

Mr. ANTHONY. Thank you.
Mr. Long.

STATEMENT OF DENNIS LONG, FINANCIAL CONSULTANT, SCIENCO, INC., MEMPHIS, TN

Mr. LONG. Thank you, Mr. Chairman.

I am Dennis Long, consultant to Scienco, Inc., which is a small pump manufacturer located in Memphis, TN. Scienco's principal product line is transfer pumps, which are used in agricultural and petroleum applications. The company is 20 years old and has approximately 40 families depending on it for their livelihood. In the company's 20 years of operation, there has never been a product liability loss or even a claim.

Despite this track record, Scienco is among the statistics of companies suffering tremendous liability rate increases for both underlying primary coverage and umbrella coverage. The respective rates increased 356 percent and 1,432 percent. These increases were achieved only after making a considerable investment in terms of dollars and man-hours.

With all of the horror stories of companies' coverages being canceled even prior to renewal dates, we became concerned that our present carrier would possibly not renew our coverage. Therefore, we made the decision to contact a risk management consulting firm rather than waiting on the current agent to come in at the 11th hour with a possible cancellation notice which would violate contract provisions with customers and in effect close our doors.

We considered it unconscionable to go bare in our situation. So in a somewhat hurried but controlled process, our risk management consultant was able to derive two quotes from 4 brokers and 17 insurance companies. One broker representing three major companies was unable to deliver any quotation despite diligent efforts. The other broker, a direct writer, quoted on the property coverage only, and would not quote on the liability.

Scienco's concerns about the current carrier proved partially correct. The incumbent would not quote on the umbrella and quoted an even higher increase than stated above for the primary liability. So, with hindsight, the $5,000 investment in the risk management consultant and the additional $5,000 investment in man-hours, which were not included in the stated rate increase statistics above, was well spent this year.

We are concerned about future renewals and the trend of accelerating cost and declining limits. We feel compelled to support any efforts toward reversing this trend which appears to be the result of possible bad management in the operations of insurance companies, or just the underestimation of those managements as to the impact of the judicial system on their companies. Realistic settlements, we feel, must be obtained. This may only be accomplished through an objective system rather than the current subjective, parasitic structure.

For an objective approach, we offer the suggestion of treating liability much the same way as workmen's compensation is handled. That is specified awards for injuries with caps established by statutes, dollar for dollar payments of medical bills, and experience ratings of product manufacturers. In the event of a death or a disability, we would continue current wages for a person at inflation-adjusted rates until age 65.

For cases where gross negligence is apparent, set up an additional pool to operate as an umbrella. But this also should have a cap established. The funding for this pool should come only from those companies with terrible experience ratings, not the businesses who are operating responsibly.

The other factor that must be addressed is the compensation paid to attorneys in these cases. I have no specifics on the issue, but any time compensation is based on a percentage the sky is the limit. This leaves an open invitation to play on the emotions of jurors and produce subjective awards which we feel must be brought under control.

Mr. **Anthony**. I would like to thank the panel.

I would like to talk to Mr. Griffith about the claims made. It seems to be a trend that is going all through the industry. It appears that it is probably going to trigger nationwide. It is a partial product response to try to get at the problem of not anticipating some of the problems that occurred in the asbestos case.

But if I am hearing all three of you testify, you are saying that your own insurance cost bears no relationship to your personal risk potential or actual experience.

Mr. **Lunch**. In the aggregate, Mr. Chairman, I think the insurance companies can show that there is an overall relationship. Taking the profession as a whole, they can show on a dollar-for-dollar basis premium income against expenses and indemnity payments.

My point was, how do you break this up into pieces using the asbestos as an example where there have been no claims in that field, where there have been claims in our field with such ordinary problems as the roofs leak, the walls crack, balconies fall down in hotels, et cetera.

Most of the cases in our field, unlike the medical field, are mainly property damage cases, unlike death and injury cases in the medical field. So, I would have to concede that there is an aggregate relationship, but the question is how do you break it up into packages and decide we will not grant any insurance coverage for asbestos or for pollution-related activities?

Mr. **Anthony**. So when you start breaking it up into separate elements, you start running into the problem areas for engineering and professionals, as far as asbestos. In other words, no claims, no experience, just a fear of the unknown?

Mr. **Lunch**. Based on a fear of the unknown. And I might add on the claims made point, our program, which goes back 25 or so years has always been on a claims made basis because of the so-called long-tail problem. Most of these claims developed years after the work was done; 5, 6, 7, 8 years is not unusual.

Mr. **Anthony**. Mr. Griffith, do you have an additional response that you would like to make over and above what was in your testimony? You underlined the words "extremely harmful" to the unsophisticated buyer on the claims made.

Mr. **Griffith**. Yes, sir.

The industry is making a stand that the implications of the claims made policy will be able to give them some kind of handle on potential losses down the road, which it probably will. However, they also state that the claims made form is going to be less expensive to the buyer. And I just cited a clear example where that is not fact at all, with a premium from $5,500 to $80,000. It is contrary to what the industry is trying to put forth to the public.

Mr. ANTHONY. You know what the industry said when they testified? They said that no businessmen complained over the last 7 years because they artificially held the rates low while they were enjoying investment income.

But is that any reason to justify such increased costs on small business in 1 year knowing no reasonable businessman will have an opportunity to pass through those type of increases?

Mr. Long, you seemed like you wanted to respond, too, so when Mr. Griffith gets through.

Mr. GRIFFITH. Prices are greater today, but this isn't the first time—in 1973, 1976 and the same thing in 1979. It runs in cycles of three.

The industry will never learn to underwrite a risk, get stability in the industry. And, if I may say so, would I be—I am going to say it anyhow—greed, sir, has caused this problem, whether you want to believe it or not. And, as a result of this greed, they have put the American public in jeopardy in regards to the insurance industry.

It is just as important to have utilities, and it is just as important to have insurance.

Mr. ANTHONY. Thank you very much. I see my time has run out.

But, Mr. Long, did you want to respond?

Mr. LONG. I couldn't agree more. I don't know anybody that will argue take more for a product that you offered at a price. But the person selling the product has to establish a reasonable price for the product, to begin with.

Mr. ANTHONY. I come from a family of small business people. I had so many relatives in the business that I decided to go off and do something else. But they share a common experience with you. They can only get one club for half the coverage and three times the premium. So their cost today is six times what it was last year.

And when they happen to be in a competitive business, being hurt by imports—so they can't pass through the costs, and the costs were absorbed by the small business itself.

I thank you for your contributions to the record.

Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

I want to thank the panel for its contribution and especially I am grateful to Mr. Lunch for commenting in addition on a question that I had raised before.

There seems to be a thought running through the panel that if you haven't had claims yourself, the insurance company is unjustified in raising your rates.

Do all of you make that the basis of your claim?

Mr. LUNCH. No, I don't think that would be a fair statement.

We were saying before the whole concept of insurance is spreading a risk among a large number of people, so the fact that company A has not had a claim does not mean that company A should not pay a part of the increased cost that has been experienced by other firms in the same category.

I don't know if my colleagues would agree with me or not, but——

Mr. **FRENZEL**. I don't know enough about the insurance industry to wad a shotgun, but I know that it is a risk operation, and if I had made five bets in a row with you on football games and I had won them all, then you would have had no claim experience against me. But the next day you came to me and wanted me to take Miami while you took the Bears; I think I will be justified in turning you down, saying I don't want that bet.

Mr. **LUNCH**. In that particular case, you would have done well to take Miami, as I recall that game.

Mr. **FRENZEL**. Maybe I am thinking of the wrong game. But as I recall, the Bears pinned the tail on Miami. Anyway, would you put up your dough to insure a toxic waste risk or an asbestos risk or a day care center risk or a medical liability risk or a product liability risk, given the conditions that obtain today in our environment?

Mr. **GRIFFITH**. May I answer that?

Mr. **FRENZEL**. Sure.

Mr. **GRIFFITH**. You see, the consumer or the manufacturer is not in the risk-taking business, per se. However, there are some operations where it would lend itself for a person to be self-insured. And I take exception to Mr. Michael Thomas' statements this morning—Thompson—that self-insured down the road is not successful. It is successful.

The only thing with regard to the self-insured aspect of it, I would be more than happy to put some of my operations in that category, provided I could get the Ways and Means Committee to prevail on the IRS to allow us to deduct the reserves we put up.

To answer your question——

Mr. **FRENZEL**. I have introduced legislation that would allow you to do that. But the committee has not considered it.

Mr. **GRIFFITH**. All right, sir.

You see, the problem is what is known as class underwriting. If I am a carpenter, then I should be rated on a carpenter. If I am an automobile dealer, I should be rated on an automobile dealer. But because of the financial need of the companies that are absolutely just outstanding—it boggles your mind—they have to charge everybody a great deal of money. It is to get it as soon as possible. The State regulators cannot walk away with their hands clean, believe me.

Now, I think this committee can bring a great deal of pressure in regard to making it compulsory for insurance companies to operate within their limits.

Mr. **FRENZEL**. OK. Thank you.

Anybody else want to comment on this line of discussion?

Mr. Chairman, I again thank the panel and I yield the balance of my time.

Chairman **PICKLE**. Thank you, gentlemen, for your testimony. You have been very helpful.

Now we ask Mr. William Rumble, Mr. Gene Kimmelman, Mr. Robert Scott, and Mr. Des Taylor if you will come forward and take your places at the witness table.

Our first witness is Mr. William Rumble, president, G.F. Goodman & Son, Inc., on behalf of the National Association of Manufacturers.

The next witness will be Mr. Gene Kimmelman, legislative director, Consumer Federation of America.

Then, Mr. Robert Scott, vice president for taxation, Johnson & Johnson.

The last is Mr. Des Taylor, the executive vice president of the Texas Society of Architects, from Austin, TX.

Mr. Taylor, I take pleasure in officially welcoming you here to this committee. You are certainly one of the outstanding executives of your industry, and we are glad you are here.

Mr. Rumble.

STATEMENT OF WILLIAM R. RUMBLE, PRESIDENT, G.F. GOODMAN & SON, INC., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. RUMBLE. Thank you, Mr. Chairman, members of the subcommittee.

I am president of G.F. Goodman & Son, Inc., and I am here today testifying on behalf of the National Association of Manufacturers.

The National Association of Manufacturers is a voluntary business association of over 13,500 companies, ranging from very large companies to very small companies; 9,000 of the small manufacturing firms have less than 500 employees each. My own company is a company with 27 employees.

We have been in existence since 1922. We manufacture machinery for the plastics and rubber industries. The product liability situation for us has become acute, both in terms of the availability and cost of insurance, as well as the impact of the law as it now exists across the country.

I would like to just cite for you, if I can, what has happened to us over the last 2 years in terms of premiums. In April of 1984, we were quoted a rate of $17.85 per thousand, a minimum premium of $50,000. Our sales were such at that time that that rate did not allow us to take full advantage of the $50,000 minimum premium, but that is what we were forced to pay for $500,000 coverage. Our umbrella policy at that time had a premium of $2,500.

In December of 1984, 8 months after the initiation of the underlying policy, the company that was our underlying carrier was purchased by an outside insurance company and told to go out of the product liability business. We were forced to find another carrier. We were able to do so, but at an increased rate and with a deductible.

In the meantime, our umbrella carrier canceled our policy, and we had to pick up another policy for the remaining 8 months of the premium year at an increase of $3,100 for that 8-month period.

When our underlying coverage came due in December of 1985, our existing carrier quoted us a rate of $40 a thousand, double what we were paying the year before. Coupled with an increase in our sales volume, that meant that we would be paying over $100,000 for our underlying coverage of $500,000. Our umbrella carrier refused to quote.

Other quotations were in the neighborhood of $20,000 to $30,000, up from $3,100. In each of these cases, in order to pay these premiums, the requirement was for a minimum of 25 percent of the premium up front, and I found that we were just not in a position to be saddled with that level of expenditure, nor were we in a position, or do we continue to be in a position to pass on those levels of costs to our customers.

Reluctantly, I chose to go without insurance. Through the course of the last 10 years, we have had some claims. One aspect of these claims that has troubled me has been the transactional costs of each of these claims, and let me cite a few numbers for you.

We had one claim which was settled for $100, but it cost $292 to settle the claim in addition to the $100. We had another claim that was settled after four years for $2,500. $7,000 of transactional costs accrued. We had two suits within 3 months of each other from the same plant, basically, each for a million dollars. One was settled for $3,600 with transactional costs of $7,630; the other million suit was settled for $750, with transactional costs of $2,316.

We had yet another claim against us which was settled after several years of effort for $1,500. Expenses accrued of $15,000.

Chairman **Pickle**. Mr. Rumble, do you wish to continue? Your time has expired.

Mr. **Rumble**. I have just a few points, sir.

Chairman **Pickle**. The Chair will grant you 2 minutes.

Mr. **Rumble**. In order to address the problem, I think that the root of the problem has to be dealt with in the case of product liability, and that is the laws that exist today. I think that it needs to be addressed at the Federal level, and I think that any new product liability law should hold manufacturers liable only when their conduct is unreasonable; hold plaintiffs accountable if their own actions caused their injuries; eliminate frivolous lawsuits; place reasonable limits on damage awards; establish reasonable statute of limitations; establish clear guidelines on product warnings; and establish comparative responsibility based on contribution to injury.

[The prepared statement follows:]

TESTIMONY OF WILLIAM RUMBLE ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Good morning, Mr. Chairman and members of the subcommittee. My name is William Rumble. I am the president of G.F. Goodman & Son, Inc. in Warminster, Pennsylvania, and I am here today testifying on behalf of the National Association of Manufacturers.

The National Association of Manufacturers is a voluntary business association of over 13,500 companies, large and small, located in every state. Our members range in size from the very large to over 9,000 small manufacturing firms that each have less than 500 employees. NAM member companies employ 85 percent of all workers in manufacturing and produce over 80 percent of the nation's industrial goods. NAM is affiliated with an additional 158,000 businesses through its Association Council and the National Industrial Council.

INTRODUCTION

America's manufacturers are facing a absolute crisis in obtaining product liability insurance. Every day the NAM receives letters from small, medium and large-sized companies detailing their soaring insurance costs. Most tell of premium increases of 200 to more than 1,000 percent. For the higher rates, overwhelmingly the companies say they are now receiving less coverage, often having deductibles of several thousand dollars to more than five million dollars. The vast majority of those companies have exemplary records for safety. Worse yet, many companies are unable to get insurance at any cost. Some are going bare—fearful their life's work will be wiped out if they are sued. Others are forced out of business entirely, and must lay off employees.

NAM believes that the villian causing the skyrocketing insurance premiums is the hodgepodge of various state laws governing product liability. Verdicts in product liability suits are now just as likely to be in the millions of dollars as not. Little attention is given to whether the manufacturer's conduct actually caused the injury. Monetary awards have little correlation to the injured party's net economic losses. Neither the consumer nor the manufacturer is able to get prompt, fair and reasonable settlement of disputes. Only the lawyers appear to be the winners under the current system. We believe that to cure the insurance crisis a federal product liability reform bili must be passed. The nature of the problem is so grave, we believe relief must be fashioned immediately.

THE NATURE OF THE PROBLEM

A few examples will illustrate the absolute crisis situation facing American manufacturers:

My own company is a typical example of the insurance dilemma facing manufacturers. I am the president of company that produces machinery for the rubber and plastics industries. I employ 27 employees. Last year, my product liability insurance premium was $50,000. This year, my premium doubled, making the amount of insurance I would have to be about $40 per $1,000 sales. Furthermore, the umbrella coverage was eliminated and I was to receive only about $500,000 total protection for about $100,000 policy. I did not have one suit filed against me last year, and felt that I could not pass on the additional costs to my customers. As a result, I am going bare. My situation is not too different from other manufacturers.

J.S. Steel and Sons, a clayworking machinery manufacturer located in Statesville, North Carolina, says its product liability premium increased 1,558 percent from $7,700 in 1984 to $120,000 in 1986.

In the past three years, Mereen Johnson Machine Company of Minneapolis, Minnesota, witnessed its product liability insurance premium jump from $70,000 to $150,000 to $300,000. The underwriters for this woodworking machinery manufacturer told the company they will not renew its insurance policy at any price when the insurance coverage expires in May.

Mastey of Paris, a cosmetic manufacturing firm in Valencia, California, relates tha the cost of its insurance has increased by 600 percent over the past three years. More than 8 percent of the cost of its product is due to high liability premiums, despite the fact that it has not had any claims against its insurer.

Giant-Vac Manufacturing, Inc. in South Windham, Connecticut, manufacturers outdoor power equipment machines. It has had to discontinue many items to get product liability insurance at any cost. This has curtailed the company's employment by more than 25 percent. Its product liability insurance premiums have increased to the point where it constitutes 7.82 percent of its total sales costs, and it will probably increase in 1986 to more than 10 percent.

The liability insurance of McJunkin Corporation of Charleston, West Virginia, increased fivefold to $700,000 in 1985, while its coverage was drastically reduced. The company currently has a profitable division of its operation which manufactures a product used in coal mines, and employs 25 people, up for sale. The company has been advised to dispose of this division due to the extremely high cost of insurance.

The product liability insurance of Aqua-Aerobic Systems, Inc., was cancelled due to a pending claim that the insurer considers frivolous but must defend. This company has been manufacturing waste water treatment equipment for over 16 years and has never had one claim related to pollution. The manufactuers has gone to over 20 insurers to obtain quotes. Not one insurer will even give it a quote because the corporation is associated with pollution control equipment, and no insurers will write policies for companies in that line of business.

WEPCO, Inc. of Vienna, Virginia, manufactured driving aids for the handicapped. When its insurance premiums rose from $1,400 to $18,000 per year, it decide to operate without insurance. After six months, the company decided it was too risky to continue without insurance and it was "compelled to remove the products from the market to avoid personal financial disaster at the hands of an unstable, voracious legal system."

The excess liability policy of Orbit Valve Company of Little Rock, Arkansas, was cancelled in mid-term with no reason given. The company could not obtain another policy when its primary liability policy expired, so the manufacturer has an exposed period with no insurance. It finally was able to find another insurer, but the premium on the new package is over $600,000—six times the amount of the old premium, and it only provides one-third as much coverage as the former policy did.

Game Time, Inc., of Ft. Payne, Alabama, which produces balance beams reported this story: One night, between 11 p.m. and midnight, a 60-plus-year-old woman who reportedly was drunk tried to negotiate a balance beam and fell. the woman sued and recovered $50,000. The company states that the cost of its liability coverage annually is approaching $800,000, a little over four percent of sales, and that there is no end in sight.

I wish these examples were the exception, rather than the rule. But they are not. Obtaining a uniform and fair federal product liability law is a top propority of NAM and the nation's manufacturers. The reasons are apparent. Companies' very existence hinge on the ability to obtain comprehensive product liability insurance. American jobs are already being lost as a result of the crisis, and if something is not done soon by this Congress, the situation is bound to deteriorate.

STABILITY NEEDED TO ASSESS RISKS

Insurance companies must be able to assess risks in order to rationally set insurance rates for companies. Unfortunately, when there is no predictability in the system, insurance companies cannot assess the risks. According to the Alliance of American Insurers, 1984 was the worst year ever for the U.S. property-casualty insurance business. Pre-tax operating income plunged to a negative $3.8 billion. And A.M. Best Co., Inc., a private data service that surveys the insurance companies, said that in 1984 the insurance industry paid out $1.18 in claims settlements for every $1 it collected. This does not bode well for America's manufacturers. They have nothing to anticipate but higher and higher premiums.

AMERICA'S COMPETITIVE EDGE IN JEOPARDY

America's "competitive edge" is no doubt partly in jeopardy because of the soaring costs of litigating frivolous, as well as justified, cases. America has become the most litigious society in the world. In 1984, one out of every 15 Americans filed a private civil lawsuit. In total, more than 13 million private civil law suits were filed in state and federal courts.

This is not the case in other countries. A 1984 study by the Commerce Department shows that U.S. companies face insurance costs many times higher than those facing manufacturers in Europe and Japan. Some U.S. makers of machine tools and textile machinery must support liability premiums 20 to 100 times greater than those paid by foreign competitors. When will it end?

DEEP POCKET MENTALITY PART OF THE PROBLEM

Part of the problem rests with the American mentality of big business' deep pockets. The Rand Corporation recently published a report collaboratin the fact the juries do indeed award more money to plaintiffs suing corporations than when the defendant is an individual. According to the Rand report, corporate defendants pay 40 percent more than individuals. Awards against corporations were far greater when plaintiffs were severely injured—over four times greater than those aginst individual defendants.

The Rand Corporation study also pointed out that there have been dramatic increases in the number of product liability suits. Awards in product liability cases also outdistanced other types of awards. The average award to plaintiffs doubled in the 1970's—even accounting for inflation—according to the Rand study.

CONCLUSION

A growing product liability insurance crisis is jeopardizing American manufacturers' ability to do business, and is jeopardizing consumers' right to fair compensation when they are injured by faulty products. NAM believes the root of the soaring insurance costs is the direct result of the run-away, out-of-control tort system governing product liability. A federal law is needed that will provide prompt, efficient and just resolution of disputes for manufacturers and for consumers. Manufacturers do not want to abdicate their responsibility when faulty products cause injuries. But the day of the "deep pocket" mentality must come to and end. We urge that a federal product liability law be passed—and passed this year—that will:

Hold manufacturers liable only when their conduct is unreasonable. Manufacturers should not be forced to pay for injuries caused by the ridiculous and careless misuse of products by unreasonable consumers.

Plaintiffs must be held accountable if their own actions caused their injuries. Companies should not be held liable for injuries when the consumer unreasonably misused or altered the manufacturer's products. And if the consumer contributed to his injury, damages should be reduced accordingly.

The system must be revised to eliminate frivolous lawsuits. If parties who brought capricious and unwarranted lawsuits were responsible for paying the opposing parties legal costs, we believe the number of frivolous cases would be diminished.

Reasonable limits must be placed on damage awards. Punitive damages should be awarded only if a manufacturer or seller acted maliciously, and even then damages should be limited in amount.

Furthermore, actual damages should be reduced by collateral sources of recovery, such as health insurance and workes compensation.

Reasonable statutes of limitations must be crafted into the law. Manufacturers should not be responsible forever for injuries caused by their products.

Clear guidelines on product warnings must be established. The duty to warn of hazards should only be for hazards that are clearly foreseeable.

Companies should only be forced to pay for that portion of the award according to their portion of fault. That is, contribution among jointly liable parties should be based on their comparative responsibility for the injury.

If such a federal product liability law is passed, both the consumer and the manufacturer will be better off. Insurance companies will be able to better assess the risk of companies. Those with safe records will not have to fear soaring insurance rates and cancellations. Consumers will be able to predict the amount of their awards and the likelihood of winning. We would hope that a system could be fashioned that will diminish court delays, legal costs and unpredictability for both parties. The only losers under such a system will be the lawyers. We urge you to move for the good of the majority. Thank you.

Chairman **Pickle**. We thank you for those suggestions.

Now we will ask Mr. Kimmelman if he will proceed.

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. **Kimmelman**. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I would like to get to the heart of the matter real quickly. From the consumers' perspective, we have heard a lot about this crisis in rising insurance premiums and a lot about the industry solutions which appear to be to restrict citizens' rights and immunize makers of dangerous products from the cost of the injuries those products cause.

We believe this is the wrong solution to the wrong problem. For some reason, industry representatives would have us believe that our courts and juries have gone crazy. They claim the sky is falling; that they have to raise insurance premiums manyfold based on a fear, without hard evidence, that there is some relationship between insurance premiums and what courts are doing, verdicts or settlements out of court.

I think this committee knows well about a crisis that really exists: the fact that 30 million Americans on any one day lack health insurance, or 50 million Americans have inadequate health insurance, or the problems of early discharge from hospitals for medicare patients under the current prospective payment system.

Under all these supposed "crisis" reforms, do we have solutions to these real problems? None that I am aware of.

Are the reformists trying to solve these real problems? Not that I am aware of.

All the proposed solutions that we have heard from industry are nothing more than an effort to cut off citizens' rights.

Let me just run through a number of these. We have proposals to change the product liability legal standard from the strict liability State law standard to a negligence standard. This would just make it tougher for people injured by dangerous products to recover.

We have proposals to cap recoveries regardless of the nature of the injury, regardless of the costs, arbitrarily cap recoveries. We have proposals to cap fees paid to attorneys. Everybody wants to see lawyers make less, but I have heard no one propose how to represent people who can't get attorneys, and I have heard no one propose how to cap defense attorneys' fees.

We have heard discussions about efforts to eliminate suits against older products, but there have been no proposals of how to compensate people who are really injured by these older products.

Similarly, in medical malpractice, efforts to shorten statutes of limitations just make it more difficult for children injured by negligent doctors to recover.

Now, these are not rational procedural changes or ways of streamlining the tort system. These are just efforts to restrict the rights of those injured by dangerous products or negligent behavior.

The irony, Mr. Chairman, is in many States and in Canada, where some of these proposals have been put into law, we have seen no changes in the rising insurance premium rates.

Mr. Chairman, in our view it is time for Congress to ask the industry for the facts. What is the real trend in the filing of suits; in the amount of settlement; in injury awards? Does the industry or doctors discipline themselves enough? Does the industry target the penalties, like it does after we have had auto accidents, by raising our rates?

And with any other proposed changes, any of the proposed solutions to this crisis, are there assurances that insurance premiums will actually come down or that injured victims will have adequate compensation for their injuries?

If Congress believes our society has become too litigious and that something must be done, we have got a number of suggestions. First of all, we think it is time to beef up some of our public insurance programs, and rehabilitation programs; make sure that everybody who is injured by whatever product in whatever way is treated fairly.

Second, we think it is time to really punish people who delay the litigation process, and we believe that a lot of the delay comes from the defense side of the case.

Third, we think it is time to focus on preventing injuries, and the best way to do this is to promote safety. Instead of just expanding our regulatory system, we would like to see the court system piggyback on the marketplace so that those who make good products are rewarded, and those who make dangerous products pay for the injuries they cause.

In conclusion, Mr. Chairman, the consumers' interest is served only if our court system insures product safety and appropriate compensation for those injured by dangerous defective products. We believe Congress should make the industry do some housecleaning, particularly the insurance industry, before considering any legislative proposals that would reduce the rights of those injured by dangerous products.

Thank you.

Chairman PICKLE. Thank you, Mr. Kimmelman.

Now, Mr. Scott.

STATEMENT OF ROBERT T. SCOTT, VICE PRESIDENT—TAXATION, JOHNSON & JOHNSON

Mr. SCOTT. Thank you, Mr. Chairman.

My name is Robert Scott. I am vice president—taxation of Johnson & Johnson.

I want to thank you for the opportunity to appear before you today. My oral statement will be very brief. A longer statement addressing in detail the relevant tax law and possible Federal tax response to the liability insurance problem is being prepared and will be submitted for the record.

The growing civil liability insurance problem threatens the ability of many in our economy to continue to perform their routine functions. Its impact on local governments, doctors, lawyers, surgeons, et cetera, are well-documented and have been documented in the press and in the hearings.

What may not yet be clear to the public and to the Congress is that the same problems also exist within the ranks of major manufacturing corporations. It is not just the doctors and not just the city government which must face annual premium increases of 100 percent to 1,000 percent or more. Many very large manufacturing companies face a situation which is just as bad, or perhaps even worse—the failure to obtain any insurance at any price.

Johnson & Johnson is a diversified international health care corporation. For 1986, Johnson & Johnson is unable to obtain product liability insurance in the traditional commercial insurance market at any price. This state of affairs predated the recent Tylenol tampering tragedy.

When I originally became aware of this in late 1985, my reaction was that our system has run amuck when a corporation such as Johnson & Johnson cannot obtain traditional commercial insurance.

In thinking about this crisis, the thought occurred to me that if traditional lines of insurance were not available, then surely it would be appropriate to begin to consider other relief.

The liability insurance crisis apparently has many causes and probably will require more than one approach to be completely solved. At Johnson & Johnson, we are not limiting the options under consideration; yet, we are increasingly convinced that one approach which will be helpful and is probably essential is a Federal income tax response.

Current tax law allows a deduction for premiums paid to unrelated insurers as a business expense deduction under section 162. The business is allowed to deduct in the current year premiums for insurance to cover expenses and losses arising from events in that year, even though the loss may not be identified until a later year, and certainly will not be payable until a later year.

On the other hand, IRS has vigorously and largely successfully opposed similar treatment for self-insured losses in the year in which amounts are set-aside in internal loss reserves. IRS has similarly opposed deductions for premiums paid to affiliated insurers maintaining current tax rules.

Precluding a deduction for loss reserves or for premiums paid to affiliated insurance companies is highly questionable tax policy in an area in which many business entities are being forced to use such approaches because insurance from unaffiliated insurers is either unavailable or is so expensive as to be a nonviable option.

The tax response which we recommend be given serious concentrated attention is the revision of existing accrual principles to allow current income tax deductions for loss reserve contributions with certain limitations and protections. The following concepts could be the basis for such a response.

One, the Code should be amended to provide explicitly that a deduction is allowed in the current year for reserves for clearly defined categories of losses by businesses which are otherwise unable to obtain insurance at all or to obtain it at reasonable and stable rates.

Two, the deductible, loss reserve amounts should be determined each year by reference to actuarially predictable payments which will be made in subsequent years due to events in the current year. These should include at least all tort claims and workmen's compensation claims.

Three, the taxpayers should be required to fund the loss reserve trust with the deducted amounts to provide security to potential claimants. Income earned on the loss reserve assets could be actually taxable to the taxpayer. Termination of the loss reserve trust should be strictly limited to circumstances in which no further claims are pending, or are reasonably possible. Deduction for premiums paid to affiliated insurers should be expressly allowed.

I should note that these concepts are not new. Mr. Frenzel introduced H.R. 6114 and H.R. 2642 in 1982 and 1983, respectively, to achieve these stated objectives. However, what is new is the present liability insurance crisis. Accordingly, it appears that these bills provided an excellent point of departure for consideration of accruing loss reserves.

We will be happy to work with you and your staff to explore a rational tax response to this crisis.

Thank you.

[The prepared statement follows:]

STATEMENT OF ROBERT T. SCOTT, VICE PRESIDENT—TAXATION, JOHNSON & JOHNSON

My name is Robert T. Scott. I am Vice President—Taxation of Johnson & Johnson in New Brunswick, New Jersey.

Thank you for this opportunity to discuss with you the liability insurance problem which is rapidly approaching a crisis stage in our economy. My presentation this morning will focus on two of the issues which were noted in the Subcommittee's announcement of thses hearings:

1. The extent to which liability insurance has become unavailable to certain segments of the economy; and
2. The current use of self-insurance and alternatives, with particular attention to federal income tax restraints thereon.

My oral statement will provide a brief commentary on these matters for the Subcommittee. I would be glad to elaborate on them further in response to any questions you may have. A longer statement which addresses in deatil the relevant federal tax law and a possible federal tax response to the liability insurance problem is being prepared and will be submitted for your hearing record.

I. THE CIVIL LIABILITY INSURANCE PROBLEM

A. The Problem in General.—The growing civil liability insurance problem threatens the ability of many in our economy to continue to perform their routine functions. We are all familiar with the reports of local governments being forced to suspend various services because of the unavailability of liability insurance or massive increases in premiums. Doctors and surgeons in various practice specialties in numerous places across the country are accepting no new patients or are refusing to deliver certain services altogether. Accountants and lawyers are finding their premiums jumping at three-and-four digit rates. Restaurant owners are having difficulty obtaining any coverage at all.

What may not yet be clear to the public and the Congress is that the same problems also exist within the ranks of major manufacturing corporations. It is not just the doctors or just the city government which must face annual premium increases of 100 percent to 1,000 percent or more. Many very large manufacturing companies face a situation which is just as bad—or possibly even worse—the failure to obtain any insurance at any price.

B. Johnson & Johnson's Experience.—Johnson's experience is a diversified international health care corporation. For 1986, Johnson & Johnson's is unable to obtain product liability insurance in the traditional commercial insurance market at any price.

II. LIABILITY INSURANCE AND CURRENT LAW

A. Risk Management and Insurance.—Traditionally, liability insurance has been purchase as part of the overall plan which every business must undertake to deal with "risks," which are the uncertainties that business entities encounter. The best known means of planning for risks is to purchase insurance policies which require the insurer to pay for expenses and losses attributable to specific acts or circumstances. In this way, the business pools risks of certain types of losses with other persons so that the insurer, rather than the business, must grapple with the uncertainties based on the statistical information available to it.

An additional means for planning for risks is to "self-insure" by bearing the risk within the business, in which case expenses and losses are paid or suffered directly by the business. Businesses and professional groups could make much wider use of internal loss reserve devices if federal income tax rules were not subject to certain adverse interpretations. One of the Subcommittee's areas of inquiry is the current use of self-insurance and alternatives therto. I urge your consideration of revisions of specific tax rules to allow self-insurance loss reserve techniques to become a viable option.

B. Federal Income Tax Treatment.— Current income tax law allows a deduction for premiums for insurance policies as business expenses under Code sec. 162. The risks covered for the policy year may or may not result in payments by the insurer in that year. In fact, it is unlikely that most risks involving third parties will result in claims being settled within the policy year. To achieve such a result would be a modern miracle, given the pace of legal/judicial processes today. Neverthless, the business is allowed to deduct in the current year premiums for insurance to cover expenses and losses arising from events in that year, even though the loss may not be identified until a late year and certainly will not be payable until a later year.

For many years, the Internal Revenue Service has vigorously—and largely successfully—opposed similar treatment for self-insured losses in the year in which amounts are set aside in internal loss reserves. The IRS has similarly opposed deductions for premiums paid to affiliated insurers.

1. *Loss Reserves.*—Losses not otherwise covered are deductible generally under code sec. 165(a), but the year in which the deduction is allowed depends upon the tax accounting method used by the taxpayer under Code sec. 461(a). For accrual method taxpayers, "an expense is deductible for the taxable year in which all the events have occurred which determine the fact of liability and the amount thereof can be determine the fact of liability and the amount therof can be determined with reasonable accuracy." *Treas. Reg.* § 1. 461-1(a)(2).

The IRS and some courts have held that the "all events" test requires that the claim not be contested and that the "determined amount" test requires that individual claims, not aggregate liability, be identified as to their amounts.

These positions are serious restraints on the loss reserve approach. Claims against a business will generally be contested by both a self-insurer and a commercial insurer. Therefore, the individual claims generally will not be fixed until a subsequent year, after the conclusion of litigation or negotiations. And, both the commercial insurer and the self-insurer are able to predict with a high level of confidence the nature and magnitude of losses that will occur in a particular year, even though the date of payments and identity of each claimant and amount may not be known for several months or years.

2. *Affiliated Insurers.*—A deduction for loss reserves is not the only approach which has been opposed by the IRS. The Service also has successfully attacked the deduction of premiums paid to affiliated insurance companies, arguing that no true insurance contracts exist because risks are not being shifted and distributed outside the economic family of the insured.

III. A POSSIBLE FEDERAL TAX INCOME RESPONSE

The civil liability problem apparently has many causes and probably will require more than one approach to be completely solved. At Johnson & Johnson, we are not limiting the options under consideration.

Yet, we are increasingly convinced that one approach which will be helpful - and is probably essential - is a federal income tax response. Maintaining current tax accounting rules for loss reserves is highly questionable tax policy in an era in which many business entities are being forced to use such an approach because insurance from unaffiliated insurers is either unavailable or is so expensive as to be a nonviable option.

The tax response which we recommend be given serious, concentrated attention is the revision of existing accrual principles to allow current income tax deductions for loss reserve contributions, with certain limitations and protections. The following concepts could be the basis for such a response.

(1) The Code should be amended to provide explicitly that a deduction is allowed in the current year for reserves for clearly defined categories of losses by businesses which are otherwise unable to obtain insurance at all or to obtain it at reasonable and stable rates.

(2) The deductible loss reserve amounts should be determined each year by reference to actuarially predictable payments which will be made in subsequent years (including expenses of adjusting a claim or loss) due to events in the current year. These should include at least all tort claims and workers compensation claims.

(3) The taxpayer should be required to fund a loss reserve trust with the deducted amounts to provide security to potential claimants. Income earned on the loss reserve assets could be fully taxable to the taxpayer.

(4) Terminations of the loss reserve trust should be strictly limited to circumstances in which no further claims are pending of are reasonably possible.

(5) Deductions for premiums paid to affiliated insurers should be expressly allowed.

I should note that these concepts are not new. A member of your Subcommittee, Rep. Bill Frenzel introduced H.R. 6114 in 1982 and a revised version as H.R. 2642 in 1983 to achieve these objectives. However, what is new is the present liability insurance crisis. Accordingly, it appears that these bills provide an excellent point of departure for consideration of accruing loss reserves.

CONCLUSION

In conclusion, I want to re-emphasize our concern about the magnitude of the civil liability problem. A portion of the problem has been made highly visible in recent press reports. But there is a potentially larger portion which is less visible but is nonetheless real, namely the unavailability of insurance for major corporations. The possible reduction of economic activity in those business sectors which face this problem would work to the detriment of employees, shareholders and tax collectors alike. The causes of the problem are being actively debated, and hopefully they will be addressed in a reasonable way.

A well developed change in tax law can serve as a substantial response to the problem. Such a change can remove the restraints which currently inhibit the efficient accumulation of reserved funds to cover losses incurred by businesses which have no reasonable insurance alternatives.

I encourage this Subcommittee to begin the development of such a tax change, and I offer whatever assistance we can provide.

Chairman PICKLE. Thank you, Mr. Scott.

Now, Mr. Taylor.

STATEMENT OF DES M. TAYLOR, EXECUTIVE VICE PRESIDENT, TEXAS SOCIETY OF ARCHITECTS, AUSTIN, TX

Mr. TAYLOR. Thank you, Mr. Chairman, members.

My name is Des Taylor. I am executive vice president of the Texas Society of Architects, with offices in Austin, TX. The Texas Society of Architects is a component of the American Society of Architects that represents 45,000 architects nationwide.

There is no reasonable doubt that crisis in availability and affordability of liability in insurance exists. Architects are caught in the web of this crisis, and they are finding premiums skyrocketing, policies being canceled, coverages being reduced, and deductible amounts being increased.

Architects are facing tough choices over insurance. These choices include: buying less insurance and assuming more direct liability risk; going bare by operating without any liability insurance; passing on increased insurance costs to clients; or going out of business.

The number of insurers offering professional liability coverage for architects has declined dramatically. And coverage is virtually unavailable for firms with nontraditional practices, such as design/build, construction management, or repetitive design projects.

A large Austin, TX firm was nonrenewed because of adverse claims experience: For 3 years, the insurer had paid out more than collected. The firm's previous policy cost $139,000 for $10 million coverage, with a $25,000 deductible. The only insurance they could obtain was a policy offering a lower limitation, a $12 million limit, with a $100,000 deductible, for a cost of $500,000—a more than 350-percent increase.

A firm in Garland, TX was nonrenewed because a large percent of their work consisted of school projects. They began their practice in 1967, and have never had a claim. Their old policy had a $100,000 limit, with a $5,000 deductible; the premium cost $2,300. Their new policy, with the same limit and deductible, has a premium cost of $10,000, a 334-percent increase.

A Houston firm was nonrenewed because a large percentage of their work consisted of school projects. Their expiring policy cost $14,655, with a $2 million limit and a $20,000 deductible. They began practice in 1964 and have never had a claim filed against them. Their new policy with the same deductible and limit has a premium cost of $48,604—a 232-percent increase.

I could spend the rest of this day reciting similar examples. And we could spend a lot of time arguing about the contributing factors to the insurance liability crisis. Therein lies the enormous difficulty and responsibility of this committee.

It is the plea of the Texas Society of Architects and the American Institute of Architects that you leave no stone unturned in seeking solutions to this crisis.

Architects, as consumers of general liability insurance coverage, have limited alternatives for correcting these excesses.

Do we look to insurance companies? Insurers are in the business of spreading risk in our society. They assess their risk and they price it accordingly.

Do we leave it to the courts? It took 20 years of court-made changes in doctrine to create the excesses and inequities that exist in our civil justice system. We cannot wait 20 years to correct it.

We urge a serious study be given to the following reforms that will return our civil justice system to fairness and equity: impose limitations and reporting requirements for contingent fee contracts; abolish joint liability; impose statutory limitations on the award of punitive damages; require that collateral sources of payments be offset against the final judgment; impose statutory limitations on all noneconomic elements of damage; provide appropriate sanctions for filing of frivolous lawsuits.

We believe our citizens deserve a civil justice system that does not outrage our common sense notion of fairness and justice. We are prepared to work with you to assist in achieving this reasonable goal.

Thank you.

[The prepared statement follows:]

STATEMENT OF DES M. TAYLOR, EXECUTIVE VICE PRESIDENT, TEXAS SOCIETY OF ARCHITECTS

Mr. Chairman and honorable members of the Subcommittee on Oversight of the Ways and Means Committee, my name is Des Taylor. I am the executive vice president of the Texas Society of Architects, with offices in Austin, Texas, representing over 5,000 Texas architects. The Texas Society of Architects is a component of the American Institute of Architects that represents more than 45,000 architects across the Nation.

There is no reasonable argument but that a crisis in availability and affordability of liability insurance exists. Architects are caught in the web of this crisis and are finding premiums skyrockenting, policies being cancelled, coverages being reduced and deductible amounts being increased.

Architects are facing tough choices over insurance. These choices include: buying less insurance and assuming more direct liability risk; "going bare" by operating without liability insurance; passing on increased insurance costs to clients; or going out of business.

The number of insurers offering professional liability coverage for architects has declined dramatically. And coverage is virtually unavailable for firms with non-traditional practices, such as design-build, construction management, or repetitive design projects.

A large Austin, Texas, firm was non-renewed because of adverse claims experience (for 3 years the insurer had paid out more than collected). The firms previous policy cost $139,000 for $10 million coverage, with a $25,000 deductible. The only insurance they could obtain was a policy offering a $2 million limit, with a $100,000 deductible, for a cost of $500,000—a more than 350% increase.

A firm in Garland, Texas, was non-renewed because a large percent of their work consisted of school projects. They began their practice in 1967, and have never had a claim. Their old policy had a $100,000 limit, with a $5,000 deductible; the premium cost $2,300. Their new policy, with the same limit and deductible, has a premium cost of $10,000—a 334% increase.

A firm in Brenham, Texas, was non-renewed because 5% of their practice consisted of structural engineering, which is excluded from their reinsurance treaty. Their expiring policy, with a cost premium of $4,147, was replaced with a policy with a premium which cost $11,380—a 174% increase. And the new policy excludes the part of their practice which has the greatest risk of liability.

A Houston firm was non-renewed because a large percentage of their work consisted of school projects. Their expiring policy cost $14,655, with a $2 million limit and a $20,000 deductible. They began practice in 1964 and have never had a claim filed against them. Their new policy with the same deductible and limit has a premium cost of $48,604—a 232% increase.

I could spend the rest of this day reciting similar examples. And we could spend tomorrow and the rest of the week arguing about the contributing factors to the insurance liability crisis. Therein lies the enormous difficulty and responsibility of this committee.

It is the plea of the Texas Society of Architects and the American Institute of Architects that you leave no stone unturned in seeking solutions to this crisis.

We believe that an in-depth study of this crisis requires a critical reviews of the excesses and inequities of our civil justice system. These excesses are contributing to a worsenting crisis in the affordability and availability of general liability insurance coverage.

The explosion of high-dollar lawsuit judgments and the more liberal court interpretation of business and professional liability has resulted in an avalanche of unanticipated loses.

Theories of fault that are now accepted in our civil justice system appear limited only by the imagination of those representing injured parties.

Over 100 years ago, U.S. Supreme Court Justice Oliver Wendell Holmes wrote, "The tendency of the law must always be to narrow the field of uncertainty."

Uncertainty has been the casualty in our civil justice system over the past 20 years. Uncertainty, not only in th area of determining fault but in assessing damages, has not been narrowed.

The first million-dollar-award in a U.S. tort case came in 1961. In 1983, there were 360 cases settled for $1 million or more. In 1984 there were 401 such verdicts of $1 million or more.

The pendulum of our civil justice system has swung too far. The desire of some to award every claimant has made a lottery of our civil justice system.

It is like the bumper sticker that I saw recently which said, "Hit me, I need the money."

Architects, as consumers of general liability insurance coverage, have limited alternatives for correcting these excesses.

Do we look to insurance companies? Insurers are in the business of spreading risk in our society. They assess their risk and they price it accordingly.

Do we leave it to the courts? It took 20 years of court-made changes in doctrine to create the excesses and inequities that exist in our civil justice system. We cannot wait 20 years to correct it.

The excesses of our civil justice system need attention and need correction. We urge that serious study be given to the following reforms that will return our civil justice system to fairness and equity:

(1) Impose limitations and reporting requirements for contingent fee contracts.

(2) Abolish joint liability. Deep pockets should not be rapped merely for being so. Defendants should pay according to their percentage of fault. If we believe that an injured party should not be barred from recovery because he is partically at fault, rather his recovery is to be reduced by his percentage of fault, then let's be fair—treat defendants the same—make them pay only their share!

(3) Impose statutory limitations on the award of punitive damages. Punitive damages are a windfall to the claimant. Punitive damages do not reimburse the claimant for any loss. Punitive damages cannot be quantified by evidence. They have become a civil justice lottery bonus.

(4) Require that collateral sources of payments be offset against the final judgment. "Double dipping," or being paid more than once for the same injury, is a cost that we can no longer afford.

(5) Impose statutory limitations on all non-economic elements of damage, since damage elements like mental anguish are not subject to quantifying evidence.

(6) Provide appropriate sanctions for filing of frivolous lawsuits. Some protection against being sued for someone else's accident must be afforded. All of us are liable for our actions if we fail to exercise ordinary care—that is fundamental to our tort system. Why is it not fair to require some standard of care in the filing of lawsuits?

These reforms that we advocate are not intended to be all-inclusive.

It is our earnest desire that our civil justice system be reformed into one that is predictable, one that provides prompt and full compensation to injured parties by those who contribute to those injuries in proportion to their fault, and one that does not make each of us the target of lawsuits arising out of someone else's accident. We believe our citizens deserve a civil justice system that does not outrage our commonsense notion of fairness and justice. We are prepared to work with you to assist in achieving this reasonable goal.

Chairman PICKLE. Thank you.

Mr. Taylor, let me ask you about your examples. You made reference to a firm where insurance was nonrenewed because of adverse claims.

Do you attribute that to the fact that they have had some suits filed against them, or are similar nonrenewals or premium increases happening to other architectural firms in Austin, also?

Mr. TAYLOR. I think that had they had no claims filed against them, they would also have been facing a tremendous increase in the price of the annual premium, because we have numerous examples of firms who have had no claims filed against them and these firms, because of the type of practice they have, have not even been able to obtain insurance quotations; or, if they have been able to obtain them, they have been at 200 - or 300-percent increase.

Chairman PICKLE. And it cost them $500,000. That is one firm in Austin.

Mr. TAYLOR. And that is 1 year—1 year premium.

Chairman PICKLE. Is that typical of other architectural firms throughout the State—Houston, Dallas, San Antonio?

Mr. TAYLOR. We understand it is. We are hearing more and more instances similar to this that indicate that firms in many instances cannot afford these premiums and are having to operate without liability insurance.

Chairman PICKLE. What do most of them do? Just go bare and just hope and pray?

Mr. TAYLOR. Many of them, I am sure, are doing that. If they are going bare, they are hoping and praying.

Chairman PICKLE. Mr. Anthony?

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Rumble, I know that your organization has strong recommendations to modernize the tort system. You think that is the most likely way to stabilize the insurance premiums.

I have asked every witness and panel that went after the tort system to try and give me some idea of what long-range hopes we would have in lowering premium rates and in what categories, and whether or not there would be additional coverage that would be brought into the marketplace. And if you could, give some indication of what additional areas of additional coverage into.

I personally think there are some areas that could be looked at. Joint and several liability, I think, is one area for us to take a look at. Some of the others I am not quite as enamored with.

But, before I decide, I want to vote for tort reform, I would want to feel like I was getting something on the other side.

Do you feel we would get lower premiums and broader coverage with tort reform?

Mr. RUMBLE. I wish I could say with assurance we would get lower premiums. As you have heard time and again this afternoon, the reasons for the rises in premiums leave a lot of questions as to how they are arrived at.

I think in the area of product liability as relates to manufacturers of machinery, which is what I can relate to tort reform, would hopefully stabilize the situation and allow the risk to be more readily assessable. As it is, the claims are becoming more frequent and the judgments larger, at an almost exponential rate, it seems.

Mr. ANTHONY. If you look at selected passages of the Rand study, it looks like it is running amuck. But when you look at it and adjust for inflation and population, the average judgment has not gone up that great. It has remained flat over the last several years.

So it is almost like we have two systems: one, that there is no problem in; and another one where we do have some problems.

But the response so far I am hearing is to reform both of them. But before I make up my mind to vote to reform the whole system, I am certainly going to have to have a better promise out of the industry itself that they are going to give us something in return for that.

Right now, what is driving us all here is the fact everybody's insurance premium has gone up so high they can't afford to pay it.

Mr. RUMBLE. It certainly is a complex situation that I don't know that you can point your finger at any single piece of it and say that is in fact the root of the problem and that is the only thing that needs to be addressed. I think it has to be a multifaceted approach, for sure.

Mr. ANTHONY. I am glad to hear you say that, because some of the other witnesses that have come in have basically just said it is the tort system, tort system, tort system. If we change the tort system, then we will be able to get it straightened out. To me, that is a much more balanced approach as to what you have just said.

Mr. Scott, on your tax proposal, would you propose to put aside less or about the same amount of money into a reserve that you would have been paying in 1985 for insurance?

Mr. SCOTT. Well, I think that is a matter that should be developed. For example, one of Mr. Frenzel's bills would have discounted the premium in one of two ways. If we are to pursue this, that surely is something that I think really would have to be looked at, whether that deduction would have to be discounted in some way, take a present value.

I am really—we don't have a firm proposal. This is a very complicated system. And what we are trying to do is just address it and ask the committee to consider it. I think that is something that probably makes sense if we are going to go forward.

Mr. ANTHONY. So you are just saying this is another one of the broad approaches that Mr. Rumble mentioned, to take a look at it, hold some hearings, and study it, and try to develop some facts; and if it seems like it is workable, then think about it and enact it into law.

Mr. SCOTT. As I said, the problem is many-faceted and there are probably going to be many cures to it, at least as far as we are concerned.

I think Mr. Frenzel's two bills provided if you are going to try to enact a tort reform, examine a tax response. Mr. Frenzel's two bills provided, I think, an excellent point of departure.

Mr. ANTHONY. Thank you very much, Mr. Chairman.

Chairman PICKLE. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

I would first like to thank Mr. Scott for remembering my bills. Your memory is much better than that of the committee chairman who somehow has forgotten about them over the years.

I think, as Mr. Rumble would tell us, they are simply one way of getting at the problem. They apply mainly to large units, with the capacity for self-insurance, who are willing to accept a level of risk if they get a similar writeoff to that which their insurer would get.

Mr. Rumble, what interested me about your testimony was the administrative costs. We have been told by a variety of witnesses that torts aren't a problem because the average claim isn't very much more than it was before; never mind if there are a lot more of those claims.

But I think you pointed out something that has bothered me. It costs us a hell of a lot more to manage the amount of claims we have. In the old days, you can lose a couple hundred thousand bucks to an injury with one lawyer. Now it takes you a whole battery of lawyers to lose a similar amount, plus a platoon of accountants and administrative people to follow the case along.

The numbers that you cited from your own self-insurance business look to me like you have got 3-, 4-, 5- to 1-ratio of administrative costs to actual claims paid?

Mr. RUMBLE. First of all, our self-insurance situation has only existed since December 31. The numbers that I cited to you were claims that we have experienced over the last 10 years, but those numbers are insurance company numbers that relate to defense costs, and they exclude any costs that were incurred by our company itself in defending these exact same claims, primarily my own time.

Mr. FRENZEL. OK. So you have no claim, or no administrative claim record of your own yet.

Mr. RUMBLE. No, sir.

Mr. FRENZEL. And you think—you pray you can do it more cheaply than your insurers.

Mr. RUMBLE. I pray, surely.

Mr. FRENZEL. I thank the panel for its good work, and I yield the balance of my time.

Chairman PICKLE. Mr. Guarini.

Mr. GUARINI. Mr. Rumble, to follow up on that, I pray that the people you make products for, that if they do have a justifiable cause of action in product liability, you will have the legal responsibility to be able to meet that responsibility. So, you see, it can cut both ways.

Unfortunately, you get shortchanged by having too high insurance premiums. But there are a lot of people out there that have justifiable claims. And I remember one claim in my district of a person who worked for the post office, and on Christmas Eve—he was about 20-some-odd years old—he was working and he went through a conveyor belt and he died the most horrible death in the world. And when the lawyers checked to find out who was responsible, they found out that the people who made the conveyor belt had gone bankrupt and had gone out of business.

So, you see, there are a lot of victims of the system, too, on the other side. We always complain about how badly we are affected, but there are a lot of people out there, because of companies going into chapter 11 or because of companies not having financial responsibility, that people don't have satisfaction of their claims, even though they have a justifiable cause of action.

So, I just want to bring that to your attention and put it on the record that that is where, unfortunately, there is a great beef. There is also a good part of the public out there that isn't adequately protected, that deserves better protection from corporate America.

Mr. **Rumble**. I would like to say, sir, that no one feels more anguish over any claim that is filed against my firm than I do. I have been involved in the defense of every single one of them, and——

Mr. **Guarini**. My statement wasn't made directly to you. My statement was made to the victims of accidents that have not been able to obtain satisfaction by a claim because of the inability of the company to be a responsible corporation, and make products that are defective and, at the same time, not be there to back them up.

Mr. Scott, in regard to Johnson & Johnson, you have a very fine company from New Jersey, and I am very proud that Johnson & Johnson is part of New Jersey. I am surprised that they have no insurance in products liability.

Mr. **Scott**. I was, also. It came as a great shock.

Mr. **Guarini**. Could I ask you whether or not you have any captive insurance? Have you set up your own insurance company anywhere?

Mr. **Scott**. We have a captive insurance company.

Mr. **Guarini**. Then you are insured?

Mr. **Scott**. As I indicated, we are insured; but we do not get a deduction for those payments.

Mr. **Guarini**. You do get a deduction if you have a captive insurance company.

Mr. **Scott**. No, you don't, no.

Mr. **Guarini**. You mean you have your own self-insurance company. You are not with a combination of other people in the industry.

Mr. **Scott**. In effect, a captive insurance company is self-insurance without a deduction. We are doing that. It is just a convenience.

Mr. **Guarini**. There could be several pharmaceutical companies that could combine and form an insurance company themselves.

Mr. **Scott**. I see what you mean, yes. There are, as a result of the insurance crisis, companies banding together to attempt to pool resources for product liability.

Mr. **Guarini**. Has Johnson & Johnson done that at all?

Mr. **Scott**. Yes. There is one called Ace, which includes some banks, some chemical agencies, one or two pharmaceutical companies, but for a very limited coverage.

Mr. **Guarini**. Where are they insured? In Bermuda, offshore, or within the United States?

Mr. **Scott**. I really don't know.

Mr. **Guarini**. There are some corporate abuses of that program, too, where they set aside more money than they would normally have to, and then that money is tax free in an offshore tax haven, such as Bermuda.

Mr. **Scott**. No, it is not. It is not tax free. The captive insurance company provides no tax advantages.

Mr. **Guarini**. If you sent the money to Bermuda, which has no taxes on insurance income, and paid a premium together with other pharmaceutical companies, whatever excesses would be, they would be able to obtain it tax free, which would be another form of tax shelter that large corporations use.

Mr. Scott. I was referring to our own particular captive where there is absolutely no tax advantage. I don't know where Ace is incorporated, so I don't know their situation.

Mr. Guarini. Do you know how much it would cost the United States, your corporation and other corporations and small businesses and big businesses and professionals and nonprofessionals and nonprofit organizations and municipalities—I strike the last two—but if everyone was allowed to set aside reserves for the future, do you have any idea what the enormous costs would be to the Treasury of the United States?

Mr. Scott. I think if we are to pursue this—that surely is a question that has to be addressed. Whether it is enormous, I really don't know.

Mr. Guarini. Wouldn't you imagine that would induce a lot of companies to use that as a tax shelter and to be able to set aside huge sums of money?

Mr. Scott. I don't think there is any tax shelter in it.

Mr. Guarini. You are saying if you set aside reserves this year for an accident, and you are a self-insured, for moneys to be paid 3 years from now and the culmination of a lawsuit, that you wouldn't be playing the same reserve game that an insurance company would be playing?

Mr. Scott. Well, in Mr. Frenzel's bill there would be some mechanism to get a present value of those deductions that would then go into a trust. The trust would be run as a trust. The funds would not——

Mr. Guarini. You would still be setting aside reserves for the future, and that would be money that the Government would not get this year but would have to wait several years, so you would have use of that money while it is put in reserve.

Is that correct?

Mr. Scott. No, no, no, we would not. Under the proposal we have set forth here, which is just one of many, the idea would be that the moneys would go into a trust. The trust would be taxable. The Government would get the earnings on the trust corpus. The company would not have the use of that fund.

Mr. Guarini. But you would not be paying income tax on that particular year, so in effect would you have created an extra tax shelter in our Tax Code?

Mr. Scott. The trust would pay tax on the income.

Mr. Guarini. The trust would only pay income on the float, the income that the money makes. But it would otherwise be under our present laws income that the company would have to pay this year under our present setup.

Mr. Scott. In our case, we would like to get a deduction for that.

Mr. Guarini. I am trying to understand if this is a new tax shelter we are talking about.

Mr. Frenzel. It would be the same deduction as you would get if you placed it with an insurance company. The self-insured can't get the same deduction he would get if he places it with the insurance company.

Mr. Scott. I don't think it is a shelter. I think it is trying to get back even.

Mr. Guarini. What we are really doing is giving them the same reserve game, to corporate America, that we give to insurance companies. So, therefore, there would be extra shelters put into our Tax Code if we accepted this proposition.

Mr. Scott. I assure you I don't really know—I don't understand how insurance companies are taxed, but we are not trying to get into the game they are playing. We are merely trying to be able to get some relief from a situation where we cannot get insurance.

Mr. Guarini. What percentage of your gross product would insurance cost at the present rate, sir?

Mr. Scott. I really don't know. Our insurance people could answer that, and I would be happy to do that.

Mr. Guarini. It would be a small part of 1 percent; is that correct?

Mr. Scott. I really prefer not guessing at it. I can supply that answer.

Mr. Guarini. All right. Thank you.

[The information follows:]

In response to Mr. Guarini's question concerning insurance costs, our product liability insurance premiums at present rates (if available) would be 0.3 percent of our gross domestic revenues.

Chairman **Pickle.** Any other questions by other members of the panel?

We want to thank you, gentlemen.

Before you leave, let me say to the audience that this will conclude the hearing for today. It has been a long session and many of you have come many miles to be here. You have stayed with us all day to the end, and we thank you for it.

The committee will have another hearing on this subject next Monday, the 24th, starting at 9 o'clock. So, we will look into this question further.

This completes 2 days of hearings, and I believe we have put on the record perhaps one of the most comprehensive reviews of this overall problem. It is a serious problem and a national economic problem affecting interstate commerce more than any other one thing. So, we must continue these hearings and hopefully find out some way to approach a solution so we can come before the public with a bill. We will cooperate with all parties and try to review the whole testimony.

Thank you very much for your participation and your testimony. It has been very helpful.

The subcommittee will stand adjourned.

[Whereupon, at 4:10 p.m., the subcommittee adjourned, to reconvene at 9 a.m., Monday, March 24, 1986.]

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